TRANSCRIPT OF RECORD.

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 727

SPRING CITY FOUNDRY COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR CERTIORARI FILED JANUARY 10, 1934.
CERTIORARI GRANTED MARCH 5, 1934.

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1 Spring City Foundry Co., *Petitioner*,
v.
Commissioner of Internal Revenue, *Respondent*.
} Docket No. 21169.

For the Taxpayer: Edgar L. Wood, Richard H. Tyrrell, and H. C. Anderson, Esq.

For the Commissioner: E. C. Lake, L. A. Luce and John D. Kiley.

DOCKET ENTRIES.

1926

Nov. 9—Petition received and filed. Taxpayer notified.
Nov. 10—Copy of petition served on General Counsel.

1927

Jan. 10—Answer filed by G. C.
Feb. 2—Copy of answer served on taxpayer—Assigned General Calendar.

1929

Mar. 18—Notice of the appearance of Edgar L. Wood and Richard H. Tyrrell—in association with H. C. Anderson—attorneys for taxpayer.
Apr. 12—Hearing set June 5, 1929.
Apr. 16—Motion to transfer to the Chicago, Ill. Cir. Cal. filed by taxpayer 4/17/29. Granted.
May 23—Hearing set June 17, 1929—Chicago, Ill.
June 17—Hearing had before Mr. Siefkin on motion to continue to circuit calendar—granted. Notice of hearing sent to wrong address.
June 19—Order of continuance to Chicago, Ill. circuit calendar, entered.
June 24—Transcript of hearing of June 17-18, 1929 filed.

1930

Mar. 17—Hearing set Apr. 17, 1930, Chicago, Ill.
Apr. 1—Motion to confine hearing to issue defined in subdivsions (a) and (b) of Rule 62, filed by G. C. 4/7/30 Granted.
Apr. 17—Order of continuance to Apr. 25, 1930 entered.

Apr. 17—Hearing held before Miss Matthews, on motion. Continued to 4/25/30.

Apr. 24—Hearing had before Annabel Matthews, on motion. Continued to 4/25/30.

Apr. 24—Hearing had before Annabel Matthews—Div. 13—on the merits. Submitted—Briefs due June 25, 1930.

May 24—Motion for extension to July 10, 1930 to file brief, filed by G. C. 5/24/30 Granted.

June 2—Motion for extension to July 30, 1930, to file brief, filed by taxpayer. 6/2/30 Granted.

June 16—Transcript of hearing of April 17, 1930 filed.

June 16—Transcript of hearing of April 24, 1930 filed.

July 10—Motion for extension to July 30, 1920 to file brief, filed by G. C. 7/11/30 Granted.

July 22—Brief filed by taxpayer.

July 29—Brief filed by G. C.

2 1932

Mar. 10—Findings of fact and opinion rendered. Annabel Matthews—Div. 13—Judgment will be entered under Rule 50.

Apr. 15—Notice of settlement filed by G. C.

Apr. 19—Hearing set May 11, 1932, on settlement.

May 4—Consent to settlement filed by taxpayer.

May 13—Decision, entered. Annabel Matthews—Div. 13.

Aug. 19—Notice to send all notices to Richard H. Tyrrell, Esq. filed by H. C. Anderson.

Oct. 19—Petition for review by U. S. Cir. Ct. of Ap. 7th Cir. with assignments of error filed by G. C.

Oct. 25—Proof of service filed by G. C.

Nov. 4—Petition for review by U. S. Cir. Ct. of Ap. 7th Cir. with assignments of error filed by taxpayer.

Nov. 4—Proof of service filed by taxpayer.

Dec. 5—Motion for extension to Jan. 17, 1933 to file praecipe filed by G. C.

Dec. 13—Praecipe with proof of service thereon filed by G. C.

Dec. 5—Order enlarging time to Jan. 17, 1933 to prepare and transmit record entered.

Dec. 19—Motion for extension to Feb. 2, 1933 to settle evidence to transmit record filed by taxpayer.

Dec. 19—Order enlarging time to Feb. 2, 1933 for preparation of evidence and delivery of record entered.

1933

Jan. 12—Transcript of record sur petition for review sent clerk, U. S. Circuit Court of Appeals, Chicago, Illinois.

Jan. 23—Motion for extension to March 4, 1933 to settle evidece and transmit record filed by taxpayer.

Jan. 23—Order enlarging time to March 4, 1933 for preparation of evidence and delivery of record entered.

Feb. 8—Praecipe with proof of service thereon filed.

Feb. 8—Agreed statement of evidence lodged.

Feb. 9—Agreed statement of evidence approved and ordered filed.

Mar. 4—Order enlarging time to April 15, 1933 for transmission and delivery of record entered.

Apr. 10—Copy of order relating to transmission of original exhibits to Seventh Circuit Court of Appeals filed.

Apr. 12—Order extending time for transmission and delivery of record to May 1, 1933 entered.

November 4, 1926.

3 UNITED STATES BOARD OF TAX APPEALS.

Spring City Foundry Company,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.
} Docket No. .....

PETITION.

Filed Nov. 9, 1926.

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IT:E:SM: 60D-TCC, dated September 10, 1926, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at Waukesha, Wisconsin.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on September 10, 1926.

3. The taxes in controversy are income and profits taxes for the calendar year 1920 and for $19,848.08.

4 The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Evidences of debt received by the petitioner from the Cotta Transmission Company, Rockford, Illinois, in 1920 in exchange for merchandise sold to said Cotta Transmission Company in 1920, and outstanding at the close of 1920, in the nominal amount of $39,983.27, which were included in statutory net taxable income by the Commissioner of Internal Revenue, in his determination thereof, at their entire nominal value of $39,983.27, as accrued uncollected income for 1920, should not have been included by the Commissioner in taxable income for 1920 at their entire nominal value, as the Commissioner failed to recognize that such evidences of debt were not actual income to the petitioner in the amount of their nominal value; neither should they have been included by the Commissioner in taxable income at any value as the Commissioner failed to recognize that they were worthless and uncollectible at the close of 1920; or if the Commissioner was not in error in including them in taxable income, he was in error in denying the petitioner a deduction from taxable income, as computed by him, for bad debts equal to the amount at which such evidence of debt may be included in taxable income.

(b) The petitioner's application to the Commissioner of Internal Revenue for the assessment of its excess profits tax for 1920 under the provisions of Sections 327 and 328 of the Revenue Act of 1918 was denied in error. (The application was denied on the alleged grounds that no abnormality in either capital or income had been established.)

5. The facts upon which this petitioner relies as the

5 basis of this proceeding are as follows:

(a) During a period from March, 1920, to September, 1920, inclusive, the petitioner sold castings to the Cotta Transmission Company for which it received evidences of debt, at first in the form of an open account, in the nominal amount of $40,302.07. Of this amount, $318.80 was paid or cancelled by cash remittances or credit memorandum, leaving a balance of $39,983.27. Unsecured notes in the amount of $32,290.00 were accepted during this period in exchange for open account in such amount, leaving a final open account of $7,693.27 and notes of $32,290.00. Each of the notes, with the exception of one for $9,300.00, was renewed one or more times prior to the end of September, 1920. The petitioner was an unse-

cured general creditor; both the notes and the open account were unsecured.

(b) The debtor was unable to pay its debts to the petitioner and so confessed to the petitioner. A meeting of the creditors, including the petitioner, was held in Chicago on October 6, 1920, and later meetings were held from time to time. A Creditor's Committee, including an officer of the petitioner thereon, was appointed on October 6, 1920, and took charge of the debtor's business. The Creditors' Committee thoroughly investigated the financial condition of the debtor, and, as a result of such investigation, abandoned all hope of continuing the business and so reported prior to November 5, 1920. The Committee made every possible effort to dispose of the debtor's property but failed to ever receive any bona fide offer, or offers, whatever. However, on November
6 5, 1920, a group of Rockford citizens, hoping to save the debtor's industry to the City of Rockford, suggested a refinancing scheme to the Committee whereby the creditors were to surrender their claims for 40% of the face value thereof and such group was to raise the necessary funds for such purpose. The Committee gladly offered to acquiesce in such refinancing scheme and encouraged the group of Rockford citizens as much as possible, realizing that it would be an extremely fortunate settlement for the creditors and that it was made only because the group of Rockford citizens was attempting to save the industry to the City of Rockford. However, the group of Rockford citizens was unable to raise the funds and abandoned the scheme. As the creditors, including the petitioner, were unable to obtain any offer or offers for the property, they filed an involuntary petition in bankruptcy against the debtor with the United States District Court at Freeport, Illinois, on December 23, 1920. That Court immediately appointed the Central Trust Company, Chicago, Illinois, as receivers, and on January 10, 1921, the debtor was duly adjudicated bankrupt, after which the Central Trust Company was appointed as Trustees.

(c) Immediately after their appointment, in December of 1920, the receivers made a thorough investigation of the possibility of selling the property and satisfied themselves that every possible effort had already been made by the Creditors' Committee to dispose of the property, and that the general conditions were such that a sale of the property would barely yield enough, if enough, to meet the priority claims and ad-

ministration expenses. The debtor's plant was offered
7 for sale by the Court at frequent intervals from March
10, 1921, on, with absolutely no bids of any character being made for the property, until bids were received in connection with an offer for sale in December, 1921, although the offers for sale were extensively advertised. At the close of 1920, it was the opinion of the Manager of the Receivership Department of the Central Trust Company, who had active charge of the administration of the estate of the debtor, that a sale of the properties would realize little, if anything, more than enough to pay priority claims and costs of administration. This opinion was based upon the following existing conditions relative to the assets of the debtor's estate:

Accounts receivable not already assigned were almost entirely worthless, being worth approximately $2,000.00 only, without deduction for the cost of collection; the inventories consisted largely of special forgings, steels and dies for the manufacture of the debtor's transmissions and had only scrap value of an extremely minor amount because of their special nature; efforts made to dispose of the inventories to the original suppliers brought forth no bids of any kind; the real estate was located about a mile and a half from the heart of the business district of Rockford and could not be sold for much more than enough, if enough, to meet priority claims and administrative expenses, as (1) there was absolutely no demand or offers for the property although every effort was made to obtain offers, (2) other properties were for sale or abandoned in the district; a large pump company whose plant occupied three city blocks, located near the heart of Rockford, was for sale; several other manufacturing plants had been closed up; and Emmerson-Brantingham Company, the largest industry in Rockford, was operating with only a very
small force; and the other assets of the debtor, other than
8 cash and cash investments aggregating $1,639.73, were absolutely worthless, representing deferred charges to operations.

(d) The debt was excluded by the petitioner from its net income for 1920 on both its books and its tax return, by means of a charge-off of the nominal value of the account under the caption of bad debts, on the grounds that it was worthless and uncollectible at the close of 1920, as indicated by the attendant and surrounding circumstances existing at that time.

(e) An abnormal condition affected the petitioner's cap-

ital or income for 1920, within the meaning of Section 327 of the Revenue Act of 1918, in that a large part of the capital employed in its business was borrowed and its statutory invested capital was abnormally low and disproportionate to the volume of sales and the statutory net income. The following is a statement of the Taxpayer's borrowing as at January 1, 1920, and as at the close of each month during 1920, showing separately borrowings on single name paper signed by the Taxpayer only and on discounted paper to the Waukesha National Bank, Waukesha, Wisconsin, by the Taxpayer and on which paper the Taxpayer was liable:

	Single Name Paper		Two-Name (Discounted)	
1920	Stockholders	Bank	Paper	Total
January 1	$5,000.00	19,000.00	48,859.00	72,859.00
January 31	5,000.00	19,000.00	51,815.97	75,815.97
February 28	5,000.00	19,000.00	71,756.01	95,756.01
March 31	5,000.00	19,000.00	91,280.00	115,280.00
April 30	5,000.00	19,000.00	101,441.45	125,441.45
May 31	2,500.00	19,000.00	98,741.45	120,241.45
June 30	2,500.00	19,000.00	100,429.84	121,929.84
July 31	2,500.00	19,000.00	127,916.59	149,416.59
August 31	—	19,000.00	135,200.57	154,200.57
September 30	—	19,000.00	118,772.39	137,772.39
October 31	—	19,000.00	118,191.22	137,191.22
November 30	—	28,300.00	64,647.52	92,947.52
December 31	—	44,300.00	40,092.97	84,392.97
Average (Based on Monthly Balance)	$2,500.00	21,661.54	89,934.23	114,095.77

9 None of the two-name paper and bill of lading attached or other documents evidencing any ownership of goods as the notes were only ordinary two-name promissory notes, nor was any of such notes without recourse to the petitioner.

(f) Should it for any reason be held that the aforementioned evidences of debt should be included in the petitioner's net income, after all allowable deductions, then an abnormal condition also affected the petitioner's capital or income for 1920, within the meaning of Section 327 of the Revenue Act of 1918, in that in the total statutory net income of $119,017.36, as determined by the Commissioner of Internal Revenue (the correctness of which determination is denied by the pe-

titioner under subdivision (a) of paragraph 4 of this petition), there was included $39,983.27 as accrued uncollected income for 1920 in the form of evidences of debt, which amount was not actual income in fact and was known in 1920 to be not actual income in fact.

(g) The following is a statement of the petitioner's net sales, statutory net income, as now determined by the Commissioner, statutory invested capital, average borrowed capital based on monthly balances, and profits tax and income and profits taxes as now determined by the Commissioner, together with certain ratios relative to such figures, as undernoted, all of which figures and ratios are relative to the calendar year 1920:

Net Sales	$577,821.23
Statutory Net Income as now determined by Commissioner	119,017.36
Statutory Invested Capital	157,438.13
Average Borrowed Capital based on Monthly Balances	114,095.77
Profits Tax	38,190.41
Income and Profits Tax	46,073.11
Ratio of Statutory Net Income as now determined by Commissioner:	
To Statutory Invested Capital	% 75.60
To Statutory Invested Capital Plus Average Borrowed Capital	43.83
To Net Sales	20.60
Ratio of Statutory Invested Capital to Net Sales	27.25
Ratio of Average Borrowed Capital to Statutory Invested Capital	72.47
Ratio of Profits Tax as now determined by Commissioner to Statutory Net Income as now determined by Commissioner	32.09
Ratio of Profits Tax as now determined by Commissioner to Statutory Net Income, as now determined by Commissioner, in excess of specific exemption of $3,000.00	32.92
Ratio of Income and Profits Taxes to Statutory Net Income as now determined by Commissioner	38.71

Wherefore the petitioner prays that this Board may hear the proceeding and order that the aforementioned evidences of debt received in 1920 shall not be included in the petitioner's taxable net income for 1920 at more than the actual value thereof, to the end that what is not actual income shall not be taxed as income, in accordance with the fundamental purpose of the income tax law, which purpose is to impose a tax upon net income, and that this Board may find that at the close of 1920 such evidences of debt were worthless and uncollectible, or of a mere negligible value; and that this Board may order that the petitioner's excess profits tax for 1920 shall be computed in accordance with the provisions of Section 328 of the Revenue Act of 1918.

HAROLD C. ANDERSON,
Counsel for Petitioner,
613—15th St., N. W.,
Washington, D. C.

11 State of Wisconsin,
County of Waukesha } ss.

H. E. BLAIR, being duly sworn, says that he is President and Treasurer of the Spring City Foundry Company, above named, and is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

(Signed) H. E. BLAIR.

Subscribed and sworn to before me this 8 day of Nov., 1926.

(Signed) WALTER R. FRAME
Notary Public.

12

EXHIBIT "A".

TREASURY DEPARTMENT
Washington

IT:E:SM:60D
TCC
September 10, 1926.

Spring City Foundry Company,
Waukesha, Wisconsin.

Sirs:

An audit of your income and profits tax return for the calendar year 1920 has resulted in the determination of a de-

ficiency in tax of $19,848.08, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxapayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM:60D:TCC. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. M. BLAIR,
Commissioner.
By (Signed) G. R. NASH
Assistant to the Commissioner.

Enclosures:
Statement
Frrm A.

13
IT:E:SM:60D
TCC

Statement.

In re: Spring City Foundry Company,
Waukesha, Wisconsin.

Year	Deficiency in Tax
1920	$19,848.08

After a careful review of your protest dated May 26, 1926, against the denial of your application for the assessment of your profits tax for the calendar year 1920 under the provisions of Section 328 of the Revenue Act of 1918, as set forth in Bureau letter dated May 15, 1926, and of all the evidence submitted in support of your contentions, together with the facts presented by your representative at the conference held on July 27, 1926, the conclusion has been reached by the Bureau that no abnormality in either capital or income has been established as a fact.

Accordingly, the denial of your application for special assessment, of which you were advised in Bureau letter dated May 15, 1926, together with the deficiency in tax of $19,848.08, of which you were advised in Bureau letters dated March 18 and May 15, 1926, is sustained.

A copy of this communication has been furnished your authorized representatives, Peat, Marwick, Mitchell and Company, Metropolitan Bank Building, Washington, D. C.

14 (Caption)

ANSWER.

Filed Jan. 10, 1927.

The respondent, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, filed November 9, 1926, admits and denies as follows:

1. Admits the statements and allegations contained in introductory paragraph and paragraph No. 1 of the petition filed herein.

2. Admits the allegations contained in paragraph No. 2 of the petition filed herein.

3. Admits the allegations contained in paragraph No. 3 of the petition filed herein.

4. Denies that the respondent erred in computing or determining petitioner's tax liability for the calendar year 1920 in either of the manners as alleged in corresponding paragraph of the petition filed herein.

5. The respondent admits and denies the allegations contained in corresponding paragraph of the petition filed herein as follows:

(a) Admits that during the period from March 1920 to September 1920, inclusive, the petitioner sold castings to the Cotta Transmission Company for which the latter Company agreed to pay $40,302.07, but denies that said Cotta Transmission Company became insolvent during said year, or the petitioner determined said debt to be worthless prior to December 31, 1920, or charged said account off its books and denies all other allegations contained in corresponding subparagraph of the petition filed herein.

(b) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(c) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(d) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(e) Denies that abnormal conditions existed affecting the petitioner's capital or income for 1920 within the meaning of Section 327 of the Revenue Act of 1918, or that a large part of the petitioner's capital employed in the business was borrowed.

(f) Denies the correctness of the statements, arguments and conclusions contained in corresponding subparagraph of the petition filed herein.

(g) Denies the allegations contained in corresponding subparagraph of the petition filed herein and demands strict proof thereof.

Wherefore, it is prayed that upon final hearing of this appeal the petitioner's tax liability for 1920 be redetermined to be the sum of $19,848.08.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BRUCE A. LOW,
Special Attorney, Bureau of Internal Revenue.

37 UNITED STATES BOARD OF TAX APPEALS.

Spring City Foundry Co.,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
} Docket No. 21,169.

STATEMENT OF EVIDENCE.

Filed Feb. 9, 1933.

The above cause came on for hearing before the Honorable Annabel Matthews, Member of the United States Board of Tax Appeals, upon the 24th day of April, 1930, at Chicago, Illinois, there being present the petitioner and respondent, by their respective counsel.

Thereupon the following proceedings were had and testimony heard by said Member. All of the evidence introduced by both parties to said cause, which is material and necessary to the determination of the assignments of error set out by petitioner in its petition for review by this Court of the decision of the Board of Tax Appeals, is herein set out in narrative form.

All of the exhibits referred to in the testimony and proceedings as listed on the schedule annexed hereto are made a part of this statement of evidence as if fully set forth herein.

38 HENRY E. BLAIR, having been first duly sworn as a witness on behalf of petitioner, upon Direct Examination testified as follows:

I am Mr. Henry E. Blair. I live at Waukesha, Wis., and am connected with the Spring City Foundry Company, the taxpayer and petitioner in this action, as a director. The nature of the business of that company is the manufacture of gray iron automotive castings. I was connected with that company in 1920 as president and treasurer. I became connected with the company in 1914. I have been in the foundry business since 1914. I have been in business since 1880. I started out working in a bank in 1880, and was post-master at Waukesha, and from there to the Spring City Foundry Company.

I am also connected with the Waukesha Motor Company as a director and Waukesha National Bank as a director. I have been a director of the bank about ten or twelve years. I was a director of that bank in 1920. The board of directors have regular semi-monthly meetings, in which the directors as a board go over the loans and discounts made during the previous two weeks; and in case of any loans that come up that the officers do not feel justified in making on their own responsibility, they call in some of the members of the board of directors before the loans are passed. They have a discount committee of three members. I participated as an active member of the board of directors of that bank and have ever since I was elected a director.

39 The capital of the bank at the present time is $300,000, the surplus $300,000, and the undivided profits are, I think, about $160,000. The capital in 1920 was $250,000, the surplus $250,000, and I couldn't say that the undivided profits were, but they were somewhere around $80,000 to $100,000. I consider, from my business and banking experience, that I am in a position to judge financial statements and the meaning of them. I think I was in 1920 also.

Mr. Tyrrell: In connection with this witness' testimony, I wish to have marked for identification this document, which is a certified copy of the order of the District Coprt of the United States for the Northern District of Illinois, entered on December 24, 1920, certified by the present Clerk of that court, which order appoints the Central Trust Company of Illinois as receiver of the Cotta Transportation Company, bankrupt, which I shall later show followed by one day the filing of the petition in bankruptcy.

(Said document so offered and received in evidence was marked "PETITIONER'S EXHIBIT NO. 1", and made of this record.)

Witness: I was president and treasurer of the taxpayer in 1920. I was active in its affairs. My duties were office manager and manager of the affairs of the company, financially. I devoted all of my time to the affairs of that company, except such time as the bank's duties required.

40 I had charge of the credits of the company, the collection of accounts, and other office affairs. In my work with the taxpayer I came in contact with the Cotta Transmission Company, of Rockford, Illinois. It was back around 1914 or 1915. They were purchasers of our manufacture. The condition of the account in the fore part of 1920 was

fairly good. Up to the latter part of 1919 and the early part of 1920, they had been very prompt in meeting their obligations. Sometimes they would give us notes on account, but when the notes came due they were taken up—they were paid, I should say. Later on they commenced to drag a little, they were slow about paying the notes, and when a note came due they would pay part of it and ask for a renewal of part of it, and this we granted. Along about the middle of 1920, Mr. Rieber, of the Cotta Transmission Company, came into our office one day and said that they needed a little extension of credit, and asked us to renew the notes of their's which we had on hand, or rather which we had discounted at the bank at that time, for ninety days or six months—I have forgotten just the time that he asked for—and he said that he had seen one or two others of his largest creditors and they had agreed to it. We told him at that time if the rest of his creditors were doing it, we would do the same thing, and grant the credit, and when the notes came due we renewed them. Some time after that we received notice of more serious financial difficulties of the company. Some time in October, I think it was, we got a telegram from the Cotta Transmission
41 Company, or from Mr. Reber,—I have forgotten who it was signed by just now—asking us to be present at a creditors' meeting in Chicago here, and asking us to have some one there in authority to act at that meeting. I have here a copy of a telegram received on October 5, 1920. By refreshing my recollection from this telegram I can state the date of the meeting that I have just referred to. It was October 6. When I attended the meeting referred to I took with me a statement of our account and a statement of the notes; the account of the Spring City Foundry Company, the taxpayer. This other paper that I have with me is the statement of account that I took with me. Those are my figures on the account, at the foot of the account. The following transpired at the creditors' meeting:

The Cotta representative there said they were in financial trouble and needed an extension, and asked for an extension on all of their accounts from all of the creditors for the period, as I remember it, of five years, and asked the privilege of giving notes for that time; and the matter then went to discussion among the creditors, and they didn't see fit to grant the extension at that time; and as I remember, there was a committee appointed at that time to look into the financial condition of the Cotta Transmission Company, and re-

port back to the creditors at some later meeting. There was a statement of the Cotta Company read at that meeting, and as I recollect it the meeting asked that the Cotta Transmission Company make a statement the same as they had
42 at the meeting, or make a financial statement anyway, and mail it to each of the creditors. This was done, and the Spring City Foundry received a copy of the statement from the Cotta Transportation Company in a few days after that, four or five days later I think it was.

Mr. Tyrrell: I show you what purports to be a letter upon the letterhead of the Cotta company, dated October 11, 1920, addressed to your company, marked for identification as exhibit No. 2, also a statement attached to this letter by a paper clip, marked for identification as exhibit No. 3, and ask you what those documents are?

Witness: Well, this is the statement of account as requested by the creditors at that time to be sent to each one of the creditors, and the letter is the letter accompanying the statement. This was received by us shortly after the date of the letter.

(Said documents so offered and received in evidence were marked "PETITIONER'S EXHIBIT NO. 2", and "PETITIONER'S EXHIBIT NO. 3", and made a part of this record.)

I recall some of the creditors who were present at this first creditors' meeting. I didn't know all the creditors there; there was quite a number, quite a room full. That was Mr. Werra of the Werra Aluminum Foundry Company, of Waukesha; and there was a representative from the Obenberger Forge Company, of Milwaukee; and a Mr. Kelly, of the
43 LaSalle Steel Company, of Chicago; and a Mr. Jackson from the Ryerson Steel Company, and a Mr. Hoagland. He was representing the National Lock Company, of Rockford, and also the New Departure Bearing Company, I think it is, of Bristol, Conn.

Mr. Tyrrell: I show you, Mr. Blair, certain documents marked for identification as exhibits Nos. 4 and 5, and ask you to state what they are?

Witness: That is a copy of a resolution passed at the meeting held on October 6th here in Chicago, and this resolution asks for the appointment of a committee of the five largest merchandise creditors. Both of these documents numbered 4 and 5, come to the Spring City Foundry Company in the course of the mail, shortly after the date of the letter. The

original copy was signed and sent back. This was sent for our approval. This is a copy.

Mr. Tyrrell: Exhibit No. 4 for identification is a letter dated at Rockford, Illinois, October 8, 1920, and is apparently a multigraph letter, reading as follows:

"Dear Sirs:

Enclosed please find copies of resolution proposed and passed at a meeting of the western creditors at Chicago October 5, 1920, and approved as amended at a meeting of our eastern creditors held at Buffalo October 6, 1920, and at a meeting of the Rockford creditors held October 8, 1920."

44 It then gives a list of the five largest creditors, consisting of the John Obenberger Forge Company, the New Departure Manufacturing Company, the LaSalle Steel Company, the Spring City Foundry Company and the Werra Aluminum Foundry Company. The letter states it is "Wena", but the witness has testified it is "Werra", which we submit is correct.

Witness: "Werra" is correct.

Mr. Tyrrell: Document No. 5 for identification is the resolution adopted at the Chicago meeting of the creditors of the Cotta Transmission Company on October 6, 1920. There is apparently an error here in the date of that meeting. The witness has testified it was October 6, which coincides with the date set forth on exhibit 5.

"A committee of the five largest merchandise creditors, or to be appointed by them, shall be credited as an executive committee to have charge of the business of the Cotta Transmission Company, co-operate with the present management until December 15, 1920; that during that period a moritorium be declared; and said committee meantime shall devise and present to the creditors a plan of re-organization and continuance of the business of said company, and submit same forthwith to the creditors of the company."

The amendment made by the meeting at Buffalo was and is that the date fixed in the above quoted resolution should be November 15, 1920, instead of December 15, 1920, if possible.

45 (Said documents so offered and received in evidence were marked "PETITIONER'S EXHIBIT NO. 4", and "PETITIONER'S EXHIBIT NO. 5", and made part of this record.)

Witness: Shortly after this meeting in Chicago I went to Rockford, Ill. We went there to look over the plant. Mr.

Reichl went down, who was with the Spring City Foundry; he was secretary and manager. Mr. Reichl died a little over a year ago. I think Mr. Kelly of the LaSalle Steel, Mr. Werra of the Werra company, and I have forgotten whether Mr. Jackson was with us then, or not. I don't know whether there were any others, or not. During this trip we went over and looked through the plant and real estate, talked with the managers of the company, and inquired into the affairs as best we could; and as I remember it, we asked the Cotta Transmission Company to have an audit made by an authorized accountant, and submit it to the committee for the benefit of the creditors, so that we might be a little better advised as to the exact condition of the company as to its financial standing. We made as thorough an investigation of the affairs of the company at that time as we could in the short time there. We went through, looking things over. We talked with the officers of the company as to the accounts and so on. After we got through the plant and looked over their stock and equipment and so on, our conclusion was that there wasn't very good prospects for getting much out of the claims
46 which we had; and the feeling that we went away with was, it was a pretty poor prospect. After that we received the audit report I have just referred to.

Mr. Tyrrell: I show you a document bearing upon its cover, "Cotta Transmission Company. Report of examination as of October 5, 1920," and directed to the committee of the creditors of the Cotta Transmission Company, Rockford, Illinois, under date of October 25, 1920, upon the letterhead of Arthur Young & Company, Certified Public Accountants, and ask you what that document is?

Witness: This is a copy of the record which we received from Young & Company of the audit of the book of the Cotta Transmission Company. That was received by the committee pursuant to the request of the committee. The committee, in investigating the affairs of the debtor, used this report. Upon the basis of this report as verified by the examination of the company's assets and the business at Rockford, the committee came to a conclusion upon the nature of the debtor's situation. This report was received by me and by the other members of the committee shortly after its date of October 25th.

As shown by the financial statement contained in this report, Exhibit 6, the company had practically no working cap-

ital. It shows cash here of $1,659, I think it is. That
47 was practically no working capital for an institution of that size. Market conditions in the automotive industry in the latter part of 1920 were very bad. The slump had come in the general trade, and the automotive industry felt that as bad, or worse, than any other in the country. I was apprised of that fact through my connection with the Waukesha Motor Company as well as in our business. Our business dropped off in that time, about in August of 1920. This condition had its effect upon the Cotta company, but they were in financial straits before the slump came. General business conditions during the latter part of 1920 were very bad all over the country. In my experience as a foundry man I have had occasion to refer to the publication called "The Iron Age"; it is one of the standard publications of the foundry industry.

Mr. Tyrrell: I show you such publication, marked for identification exhibit No. 7, and ask if this is such publication?

Witness: It is the publication of January, 1930, dated January 2. It contains the prices of pig iron during the year 1920. This publication has a very high standing among foundry men, and they refer to it and depend on its quotation. It is the recognized publication for quotations on pig iron and other materials in the iron industry. I have looked it over and I know it shows large fluctuations. I also know
48 from my personal knowledge, as to the changes in the pig iron prices during the year 1920. The price dropped very materially, dropped somewhere around $14.00 or $15.00 a ton. Pig iron prices are considered a very stable product as a market. A small fluctuation in the iron market makes a foundryman sit up and take notice, for the quotation he makes on his product. A fluctuation of 50 cents or $1.00 a ton is a marked fluctuation in the iron market. I have heard that pig iron prices are considered as somewhat of a weather vane of market conditions. They run along and in 1920 they went up gradually until it got to August or September, and then in August or September I think they took an almost vertical drop, falling, to the end of 1920, to approximately 30. That would be a drop of nearly $18.00. I think it is about right, to the best of my recollection of what the market was at that time. We got caught on it. I consider that a very serious drop. By "getting caught" I mean we had contracts out for iron that we had purchased for future delivery at the high prices, not at the peak price I don't mean. We weren't

up to the peak, but we were pretty well up. My knowledge of this decline in prices is based upon my experience in the foundry business and also as a banker, but largely as a foundry man is where it affected us. As a result of our investigations in the latter part of 1920, of the conditions of affairs and the properties of the Cotta Company, together with our knowledge of market conditions at the time, and
49 the general depression in business that I have referred to, we came to a conclusion as to the value of the Spring City Foundry's claim against the Cotta company. We came to that conclusion along in November or December of 1920, that it was valueless; didn't expect to get anything on it at that time, hardly. The claim of the Spring City Foundry Company against the Cotta company was not secured in any way; it was an open account and notes that had been given for the open account. This claim was not protected by insurance nor in any way. It was absolutely an unsecured claim.

At the time of the filing of the petition in bankruptcy we felt that the Cotta company was insolvent. We had taken every means that we could, we felt, to get an adjustment or payment on account, and couldn't get anything. This opinion was based partly on our investigation in connection with the activities of the creditors' committee and partly on our own investigations. The general concensus of opinion of the creditors' committee was that the general unsecured claims against the Cotta company weren't any good. That was in December of 1920. The Spring City's claim against the Cotta company was in the latter part of 1920, charged off in full on the Spring City's books against profit and loss. I directed that that be done in conference with my partner in the business, who was treasurer and manager of the business. In conference together we decided that it should be charged off, to show the status of the assets that we had, and the right
50 thing to do as a business proposition, to charge it off, because we at that time didn't expect to get anything out of it, and we felt at that time that the account was valueless; and I believe yet that it was at that time. We considered it the exercise of prudent business judgment to do so. I did not consider that it was desirable to include this account against the Cotta company as an asset in the statement of the Spring City Foundry Company, to be submitted to bankers or others for credit purposes. In my opinion as a banker, as well as one of the officials of this business, the inclusion of this account against the Cotta company as an asset of the Spring

City Foundry Company would not have honestly reflected the financial and business condition of the Spring City company.

Mr. Tyrrell: I show you what purports to be some ledger sheets, marked for identification as exhibits 8, 9 and 10, and ask you to state what those are?

Witness: They are sheets from the liability ledger of the Waukesha National Bank, the original records. As a director of the bank I brought them here for the purpose of reference in this case.

(Said documents so offered and received in evidence were marked as PETITIONER'S EXHIBITS 8, 9 AND 10, and made part of this record.)

51 Upon cross-examination Henry E. Blair further testified:

Our secretary and manager was Mr. Riechl. He was connected with this company during 1920. We were in the business there together from 1914 on until 1927. I am familiar with his signature. That is his signature on the protest of federal income and profits taxes for the years 1920 and 1921, which has been handed me.

(Said document was marked for identification as Respondent's Exhibit "A".)

I was familiar with the activities of this creditors' committee that was appointed, and met with them on several occasions.

Page 8 of this protest refers to an offer of a group of Rockford citizens. I know why the creditors refused to accept the 33-1/3 per cent offer; I know the circumstances of that offer. The offer was made for 33-1/3 per cent, and the committee felt that if they could get a better offer out of the Rockford people it was their duty to do so; and in their dickering back and forth for a better offer, the Rockford people raised it to 40 per cent, and that was as far as they would go, and the committee, when they got the best offer that they figured they could get, accepted it, and it was on condition that the Rockford people could make good on it, could take it up, and gave them until December 15th to do so; and the conditions of it were that all the creditors were to sign an agreement to

52 accept 40 per cent in full of their claims, and deposit the signed agreement to accept 40 per cent in the bank at Rockford, I think it was the Manufacturers National Bank was the name of the institution; and the committee sent out to all the creditors a recommendation to accept this and send

in their acceptance of the proposition. Those acceptances were sent in by most all of the creditors. There was a few who held out and wouldn't sign their acceptances, but it was the small ones, the small creditors, and they could have been taken care of, I think, so it would have gone through all right had the Rockford citizens been able to come across with the money and take up the claims at 40 per cent. But they fell down on it and couldn't do it, and so the thing never was put through.

We realized that there was a value there, but there was a plant value there; that the plant was in operation, but very slightly, and it was practically only for the furnishing of repairs to the transmissions which they had out at the time. The operation wasn't making any money. The plant operation wasn't making any money. That by the time the secured claims had been paid, we did not figure there would be much left for the general creditors, after the expenses of operation and so on had been taken out.

We received a dividend in 1922 of about $8,000, I think it was, and in 1923, of about $3,500, or something like that. The dividends were 15 per cent and 12½ per cent, is what the
53 dividends were. A little over one-fourth of this indebtedness was recovered later on, but I feel that it was due to the change in business conditions in the country and in the automotive industry, from the conditions which prevailed at the end of 1920; and the same conditions continued to prevail through the years following 1920, as prevailed at that time. I doubted if there would ever be any material recovery to the creditors, and we were figuring—when we charged it off, we were figuring on the basis of matters and conditions as they stood at the close of 1920. We didn't look for any improvement in conditions for some time. We figured it would be three or four years before the automotive industry got back on its feet, to where it would be paying a reasonable profit. It was about a year and a half or so, and it really came back quicker than we anticipated.

Mr. Luce: (reading) "At the close of 1920, it was extremely doubtful if the remaining 40 per cent had more than a relatively minor cash value". I will read paragraph 5: "It was definitely ascertained in 1923 that the actual cash value of the remaining 40 per cent, which remaining amount was not previously determined to be absolutely worthless, amounted to $11,267.51."

Witness: That was ascertained in 1923, because we got

it—we actually got the money for it, and that is what it was worth. In 1920 we didn't estimate for our—that didn't
54 mean that the claim was worth $15,000, by any means. We didn't expect to get anything like that out of it.

Mr. Luce: Well, now, in this protest you say: "It was definitely ascertained in 1923 that the actual cash value of the remaining 40 per cent, which remaining amount was not previously determined to be absolutely worthless, amounted to $11,267.51." So that you actually, as to the 40 per cent of this indebtedness, did not determine it to be worthless until 1923; is that a fact?

Witness: In our judgment it was worthless. It was demonstrated in 1923 that it wasn't, but at the close of 1920, which was the time we charged this off, we didn't anticipate that it was worth anything like $11,000. That paragraph states the facts there—it states there that we didn't anticipate that they were worth 40 per cent; and we didn't anticipate that they were worth 40 per cent at the end of 1920.

Q. Now, turning to page 19, you say: "It should be equally from the facts submitted previously in this protest, that it was definitely ascertained before the close of 1920 that the actual income received from the Cotta Transmission Company, in the form of evidences of debt in the normal amount of $39,983.27, was not at most in excess of $15,993.31." That ties up with the previous page that I have read?

A. Yes.

Q. That is a fact, isn't it?

55 Mr. Tyrrell: If your Honor please, I object to this basis of cross examination, based upon a brief submitted in argument to the Bureau of Internal Revenue. This is a brief which upon its face appears was prepared by the Accountants, and verified by the officer of the company, as is required; but from the language as read, it is argumentative, and was submitted as a brief and argument; and in that respect it is not proper cross examination, or basis for cross examination.

Mr. Luce: Your Honor, this is a sworn protest submitted to the Bureau of Internal Revenue, and the facts are sworn to be true. It certainly is an admission against interest; and I propose to offer the latter as an admission interest.

The Member: You may proceed. This was filed with the Bureau, and forms part of the basis of their action. The taxpayer may be able to explain it.

Mr. Tyrrell: An exception.

Mr. Luce: Will you read the last question, Mr. Reporter?

(Thereupon, the Reporter read the pending question as here recorded.)

Witness: Yes, it is a fact that it was not in excess of $15,000.

56 Mr. Luce: Now, turning to page 29, it is stated: "It was shown previously in this protest, page 14, that after at least 60 per cent of the normal amount of the debt receivable from the Cotta Transmission Company had been definitely ascertained to be worthless, the taxpayer did not ascertain how much of the remaining 40 per cent was worthless until the early part of 1923, when this amount was ascertained to be $4,725.80." So isn't it a fact—?

Mr. Tyrrell: Just a minute. If your Honor please, I object to this cross examination. This is also an argument based upon an entirely different proposition. It is quite customary, and in fact all people acquainted with legal procedure know, that any brief presents many different points, some of which are alternative points. For instance, the argument to which counsel refers as the basis for concluding the facts here is under heading No. 5, that "the taxpayer alleges that the amount of debt receivable from the debtor in bankruptcy and charged off on its books"—and I repeat—"and charged off on its books, which amount was not ascertained to be worthless until 1923, in which year it received the final dividend, should be allowed as a deduction for 1923 instead of 1921."

Now, that is hardly the basis for cross examination.

The protest here clearly indicates, under this heading, that it is a mere matter of argument; and, secondly, that it is on an entirely different point, an alternative proposition
57 submitted by the representatives of the taxpayer.

I object to any cross examination based on that portion of the protest:

Mr. Luce: Your Honor, I think the facts upon that proposition in the protest tie definitely up with the facts which have been alluded to in this cross examination throughout; the whole protest showing that only approximately 60 per cent of this debt is ascertained to be worthless in 1920, and that the debt was actually ascertained to be worthless—part of it was worthless in 1923, instead of 1920.

That is the Government's position, and the taxpayer, throughout this entire protest, points out those facts, and finally shows, under this heading, the facts which show that

this debt is properly ascertained to be worthless in toto in 1923; and I certainly think that the Government has a right to cross examine on the facts in this entire protest; because they tie in so clearly with each other throughout the entire protest.

I am going to offer the protest later on as a Government exhibit, and your Honor will have an opportunity then to judge for yourself, after an examination of this document.

Mr. Tyrrell: I wish to ask the witness a few questions in regard to this point.

58 The Member: Wait a minute, Mr. Tyrrell. This protest was filed when the Department disallowed this deduction?

Mr. Lucc: Yes.

The Member: And it is directed to the disallowance? It is a protest against the disallowance; and from what Mr. Tyrrell says, in the alternative, if it isn't allowed them, to be allowed in 1923?

Mr. Lucc? "The taxpayers have before received copy of revenue agent's report dated October 9, 1925, covering examination made of its income tax liability for the calendar years 1920 and 1921, together your transmittal letter dated October 14, 1925."

The report is directed to the years of 1920 and 1921. The revenue agent allowed the deduction in 1921, and the taxpayer claims by this protest that a portion should be allowed for 1920, and the balance in 1923. That is the way I interpret it.

Mr. Tyrrell: No; that is not the situation. The face of the protest, which counsel has just referred to, deals with the item involved in the 1921 readjustment, and has nothing at all to do with 1920, except insofar as some of the facts may be applicable to both years. This paragraph deals with the adjustment made in 1921, and has nothing whatever to do
59 with this; and I insist it is purely argumentative; and in that connection I wish to ask the witness just two or three questions with respect to it.

Mr. Lucc: Mr. Counsel, just a minute. Is not that item involved in 1921, the very first item we have got in this case, the deduction for 1920?

Mr. Tyrrell: I think the item involved is the receipt of dividends.

Mr. Lucc: No.

Mr. Tyrrell: That is the question involved.

Mr. Luce: Did not the revenue agent allow this deduction in 1921, instead of 1920, and is not the taxpayer protesting as to the deduction of it in 1921?

Mr. Tyrrell: That may be true as to one of the points, but upon that I have this to say: The Government must be consistent; and the argument made there in that protest—and I insist it is nothing but an argument—is this: If the Government is not going to allow this in 1920, because it was not definitely ascertained to be worthless in 1920; then the Government must be consistent and allow it in 1923, when the matter was all closed up, and not in 1921. That is all there is to it.

That being nothing more than the argument of a Cer-
60 tified Public Accountant, it certainly is not binding upon the taxpayer; and it involves 1921 only with respect to that argument that I have mentioned. Counsel made the point—that is, the Certified Public Accountant made the point that, assuming the taxpayer lost its major proposition before the Board that the whole amount should be allowed in 1920, then the Government must be consistent and allow it in 1923, because that is when the matter was closed up. In other words, if they take 1920 as the time when they did not wind up the affairs, they must then resort to the time that the affairs were actually wound up.

Mr. Luce: Well, I think the protest speaks for itself, and I intend to offer it; and at that time, if counsel a desire to object, will have that opportunity.

Mr. Tyrrell: Well, I request that permission in connection with the competency of this cross-examination, to ask the witness two or three questions with reference to the document to which he has referred in connection with the cross-examination.

Mr. Luce: Go ahead.

By Mr. Tyrrell: Q. Mr. Blair, who prepared the protest that you have referred to?

A. This?

61 Q. Yes, sir.

A. Peat, Marwick, Mitchell & Company.

Q. Are they Certified Public Accountants?

A. They are, yes, sir.

Q. Did you refer the matter of this tax protest to them as your Accountants?

A. I did.

Q. And they prepared this brief in connection with that proceeding?

A. Yes, sir.

Q. And submitted to an offer of your company for verification?

A. Yes, sir.

Q. Did you have anything to do with the preparation of this?

A. Why, I had nothing to do with that, no, other than obtaining the figures and so on from our books and from their audit report.

Q. That is in connection with the general examination of your books of account?

A. Yes, sir.

Q. You had already expressed your idea of this transaction by ordering the charge-off in 1920 of the full amount?

A. Yes, I had.

62 Mr. Tyrrell: I renew my objection to the use of this document as the basis of cross-examination upon the theory that they are admissions of the taxpayer therein, it being nothing more than a brief submitted to the tax administration officials.

And I move that all of the cross-examination based upon—that is, all of the cross-examination based upon this document be stricken out.

Mr. Luce: Your Honor, this witness testified that he was thoroughly familiar with this whole situation—a great deal of testimony to that effect both yesterday and today—and that was why I was very careful in this cross-examination to conduct it as I did, to read these statements made by the taxpayer previously in this sworn document, and then ask this witness if it was a fact, and that is what I did, and he says he is familiar with the whole transaction.

The Member: You may proceed. You may have an exception, if you like, Mr. Tyrrell.

Mr. Tyrrell: I will take an exception to that.

Mr. Luce: Will you read the question, Mr. Reporter?

(Thereupon, the Reporter read the pending question, as follows:

"Q. Now, turning to page 29, it is stated: 'It was shown previously in this protest, page 14, that after at least 60 per cent of the normal amount of the debt receivable from the

63 Cotta Transmission Company had been definitely ascertained to be worthless, the taxpayer did not ascertain how much of the remaining 40 per cent was worthless

until the early part of 1923, when this amount was ascertained to be $4,725.80.' So isn't it a fact—?)"

By Mr. Luce: Q. So isn't it a fact, then, Mr. Witness, that finally the amount of this debt that could be collected was finally disclosed and ascertained in 1923?

Mr. Tyrrell: I object to that as not being proper cross-examination, being based upon a reference to an argument on an entirely different theory, involving an entirely different tax year.

The Member: It relates to the same amount, though. He has to definitely determine the amount which is to be collected in 1923.

Mr. Tyrrell: Well, does counsel mean that the transaction was finally wound up in 1923, which is quite apparent, or does the question go to the witness' understanding and belief at the end of 1920?

Mr. Luce: It speaks for itself. Will you read the question, Mr. Reporter?

(Thereupon, the Reporter read the pending question as here recorded.)

Mr. Tyrrell: Well, that is admitted by the receipt of the dividends.

64 Witness: The amount of dividends received in 1923 in there?

Mr. Luce: I am going to object to counsel answering a question on cross-examination from the witness. I offer this document.

Mr. Tyrrell: I object to it.

Mr. Luce: As respondent's exhibit A, sworn to by the taxpayer, as an admission against interest.

Mr. Tyrrell: Objected to as incompetent, irrelevant and immaterial, and for the further reason that it is nothing but a brief prepared by the Accountants for the taxpayer, in connection with an informal hearing before the Bureau of Internal Revenue, and does not constitute an admission on the part of the taxpayer as to any of the facts therein stated.

The Member: It may be received for what it is worth.

Mr. Tyrrell: An exception.

(Said document so offered and received in evidence was marked "RESPONDENT'S EXHIBIT A", and made part of this record.)

Witness: Our company charged this sum off in 1920. I have the book in the court-room.

65 Upon redirect examination Henry E. Blair further testified:

In answer to a question on cross-examination, I stated that the amount of the Cotta claim had a value not in excess of some $15,000; I did not mean to indicate that it had such a value. I didn't figure that it had any particular value. The assets of the Cotta company were sold in 1922 to a man by the name of Swartz; that was the name that showed in the transfer, but I think they were bought for a committee of citizens of Rockford, where the money was raised.

66 FRED E. HUMMEL, being first duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

My name is Fred E. Hummel. I live at River Forest, Ill. My occupation is acting as receiver and trustee in bankruptcy estates in liquidation. I entered that work with the Central Trust Company in 1912. I was in that work during the year 1920. I have been in that type of work ever since 1912. I devote all of my time to that work, and have since 1912. During the course of that period, I believe I have had considerable experience in such capacities. During the course of 1920, I came in contact with the Cotta Transmission Company of Rockford, Ill. I was manager of the Receivership Department of the Central Trust Company of Illinois in 1920, and they were appointed receiver for that company in that year. The date of that appointment was December 24th, 1920, as appears from exhibit No. 1, which is certified as being a true copy of the original order of appointment, stating that the order was entered December 24, 1920. I do practically all of the work as receiver for the trust company and did on this job.

The day following the receiver's appointment, I went to Rockford, Illinois, took possession of the business of the Cotta Transmission Company, and held a conference there with the Rockford people, the attorneys for the creditors, the attorneys for the Cotta Transmission Company, the representatives of either two or three Rockford banks, who were creditors
67 of the Cotta Transmission Company, and discussed the affairs of the concern at length. I would say it was the following day, which was Sunday, and we spent all day Sunday out there. That is my recollection of it. I found that there had been a creditors' committee active for some months there; that they had procured an audit by Arthur Young &

Company, which was turned over to us, and their activities were discussed at this meeting in Rockford. I made an investigation as to the work that had been done by the creditors' committee. I found that they had attempted, through the Rockford banks and Rockford people, to either refinance the company, so that they could get some new financing, or to find a customer for the assets of the Cotta Transmission Company. I was satisfied that every possible effort had been made by the committee to dispose of the property. The prospect, at the time I took hold, of continuing the business, was very poor.

The possibility of the sale of the premises or assets of the debtor company at that time takes a little explanation; that is, in addition to this conference we held at Rockford on that Sunday, when I returned to Chicago I discussed the situation with the officials of the Central Trust Company. Mr. W. T. Abbott was Vice-President, and as such vice-president was responsible for the Receivership Department. And in discussing it with Mr. Abbott and Mr. Bodholdt, another man in the bank, it was the concensus of opinion of the receiver that it was impossible to sell that business, in view of the condition of the automobile truck manufacturers around
68 over the country generally.

The product of the Cotta company was manufacturing transmissions for automobile trucks. That was the principal product of the company. The plant was designed for that purpose. The equipment in the plant was made for that special purpose.

It was my opinion that, at the end of—in the latter part of December, 1920, that was an unadvisable time to attempt to sell the plant of the Cotta Transmission Company. It was inadvisable at that time because I don't believe that you would have gotten much more than to pay the costs of administration and preferred claims, taxes and lien claims against the property. My opinion was based upon the general depression in 1920, the Fall of 1920, in the automobile truck business, of customers of this concern. There were five or six of the very largest accounts either in bankruptcy or in the hands of creditors' committees, who were owing this concern money. So that it would not be possible to get a fair price, or get much of any value, for the machinery and equipment, which was largely specialized for this production, at that time. As to the general business conditions in the latter part of 1920 I know that there were a large number of bank-

rupticies during the Fall of 1920, and more of them during the year 1921, and from the investigation I made at the time in the Cotta Transmission Company, I ascertained that the truck business was at a very low ebb. Among other things that went into the basis for my conclusion in this matter, I considered the accounts receivable of the trade as they were at that time.

69 I know that more than $30,000 of accounts receivable were assigned to two or three banks to secure loans down at Rockford; that a number of accounts, as I testified, were in bankruptcy. There was the Wichita Falls Motor Company, which owed the Cotta Transmission Company $30,000, that had been in bankruptcy, I believe, for several months. J. C. Wilson & Company owed the Cotta Transmission Company a large amount of money, and as I remember it they were in bankruptcy, or in the hands of a creditors' committee. There was very little realized on the accounts receivable that weren't assigned.

By referring to a copy of an affidavit that I made under date of November 1, 1926, I can refresh my recollection as to my opinion of the accounts receivable. My opinion at that time was that they were worth approximately $2,000; that is, the unassigned accounts receivable were worth approximately $2,000. The document marked for identification as exhibit No. 6 came to my attention in connection with my examination of this debtor's situation. That was turned over to me by the creditors' committee. The amount of the accounts receivable that were pledged were $63,000. The entire accounts receivable were $126,000. By referring further to this balance sheet which was submitted to me at that time, it appears that the quick assets consisted of cash in the sum of a little over $1,600.00 and accounts receivable in the sum of $126,000. And of these accounts I have testified that over $63,000 were already pledged. The accounts and notes payable were some $817,000, so that at that time this debtor

70 had quick assets of something over $126,000, but less than $130,000, and obligations and current liabilities in the sum of $817,000. I made an investigation as to the nature of the inventories of the debtor. They consisted of parts for the manufacture of transmissions, forgings, castings, some steel. They appeared in the balance sheet at $446,849. That is an estimated figure. Those materials in the inventories, except for the special purpose for which they were made, had very little value other than junk values. I

made an effort to dispose of the inventories. We advertised it for sale. We attempted to sell part of it to the suppliers of the materials, but had no response. I know we didn't sell any of it to them, weren't able to.

By referring to this audit report, it appears that the promotion and development expenses were set forth upon that balance sheet at a figure in excess of $195,000. It consisted of advertising expenses and commissions. I made an investigation as to the plant assets, the physical assets, consisting of the real estate and plant. At that time they were of small value, in my opinion. The plant was located on the outskirts of Rockford. There were a number of other plants that were closed down. There was one outfit, I forget the name of it, a pump concern down in Rockford, that covered some three blocks, that had been closed down and had been for sale for more than a year, as I remember it, at the time of this receivership. There were other manufacturing plants in Rockford in the same situation. The Emerson, Brantingham Company, which was about the largest industry Rockford had at that time, from our investigation we found
71 was operating on a very small scale, or practically shut down at that time. I also recollect this pump factory which was on the main street of Rockford. In my opinion, the value of the inventory had practically been reduced to its junk value. My opinion, at the close of 1920, was that the Cotta Company was very insolvent. It was my opinion, and that of the officials of the Central Trust Company; that by the sale of that business at that time they would get little, if anything. In the light of that opinion, I considered it the exercise of prudent business judgment for the tax-payer, being a general creditor of this company, to charge off general, unsecured claims in 1920. I so advised taxpayers that came to me for advice. I have no interest of any kind in this proceeding.

Upon cross-examination Fred E. Hummel testified as follows;

I first came into the picture on December 23, or December 24, 1920. The appointment was made at four or five o'clock in the afternoon, and I met with the attorneys for the petitioning creditors and the attorney for the Cotta Transmission Company, both were at the offices of the Central Trust Company, and I think we discussed the situation there for a matter of two hours. Judge Carpenter had told me that I wouldn't have to go down there the next day, which was Sun-

day, but that we could make it on Monday. However, the next day was Christmas, and that was all that was done on it, and then on Sunday I did go to Rockford. I was living
72 in Chicago. I spent in Rockford all of that day, all of Sunday, the 26th of December. I then came back from Rockford to Chicago. I went out to Rockford the following Tuesday and stayed all day. I made further investigations that week, both at the meeting down town and out at the plant. At the meeting down town there were the officers of some of the Rockford banks, Mr. Heyer, the attorneys for the Cotta Transmission Company, Mr. Petersen, the attorney for the creditors who filed the petition in bankruptcy, a number of Rockford people. I think Mr. Hoagland, of the Nation Lock Company of Rockford, took quite an active interest, and he was there. I believe that was the first one. The second visit out there I met the representatives of the New Departure Company, who were a substantial creditor, and they were out there. We worked on the affairs of this plant for over a year. I continued in my preliminary investigation for the period of the first week of the receivership. We investigate and are open to information and seek information as long as a case is pending.

I investigated these accounts receivable the Sunday that we were out there; we had possession of this audit, and we went over the accounts receivable with the officers of the company. This company was adjudicated a bankrupt about two weeks after the petition in bankruptcy was filed, which is the earliest it could be adjudicated. That was in January some time of 1921.

Then we held meetings off and on, we advertised the plant for sale, sending circulars to concerns, advertisement to concerns, in a similar attempt to sell the business. We did not make any attempt through advertising to sell the busi-
73 ness until after the concern had been adjudicated a bankrupt. I began to try to collect on the accounts receivable immediately after the receiver was appointed and continued until the estate was closed; that is, right along. We made collections. We paid the first dividend to the creditors in the Spring of 1922. 15 per cent. This petition received a dividend as one of the unsecured creditors. We got the money to pay this dividend of 15 per cent by the sale of the plant and assets. The plant and assets sold for $173,000, or thereabouts. It may have been $175,000. Sold it to Rockford people as the result of the advertisement.

The next dividend was in 1923, 12 per cent, or 12½ per

cent. We derived the funds to pay that dividend, part of it from the sale of the plant and from the collection of accounts receivable created by the receivership. This second dividend of 12½ per cent was also to the general creditors. By that time all of the preferred creditors had been paid off. The preferred creditors were two banks or three banks in Rockford, who had these accounts under assignment. Then in the Summer of 1921 we operated that business, that is, we filled repair orders right along. We operated the business up until October or November of 1921, and as such created some accounts receivable which we collected. Under the Bankruptcy Act, you can only pay out approximately half of the funds on hand in the first dividend, and retain enough to pay approxi-
mately a similar dividend at the final meeting; so that
74 when the first dividend of 15 per cent was paid, we didn't pay out all of the money resulting from the sale of the plant, but only paid out approximately half of it. I thought it good business not to sell the plant around about the first of the year 1921 because prices were low. I thought it was better business for myself as receiver, and for the creditors, to wait until prices re-adjusted themselves.

We advertised the sale for March 8, 1921, and we received no bids; and then we dropped the question of a sale until about September of 1921, when we again advertised it. I operated the plant; and kept over some of the old employees. I did not shut the plant down totally for longer than two weeks, I would say, at a time. The plant was in operation on or about January 1, 1921. Filling repair orders largely. We cut it down to a very few employees, discharged all of the salesmen, and operated along on a probable reduction of at least 80 per cent of the personnel for a period of six months. Then we increased the personnel, somewhat. We shut down in March, as I remember it, for the purpose of taking the inventory, and we shut it down a little later in the year, having in our employ two or three people filling repair orders. Then on or about the 1st of July, we opened it up again, at least in a partial way, and continued to keep it open and operating until we sold it. By keeping the plant in operation, we were able to get a better price than if we had closed it down the latter part of 1920. That is the reason that we kept it in operation and also to fill repair orders, with the idea
that we would collect some of these accounts receivable
75 that were making complaints on their merchandise. We began to try to collect the accounts receivable right after the receiver was appointed.

I am not with the Central Trust Company now, and have not been since 1923, but I am in the receivership business. I am not a lawyer nor a certified public accountant. I was with the bank for a period of ten years. I went with them in 1912. In 1915 or 1916 I was made manager of the Receivership Department.

With regard to my advice about charge-offs, some creditor came in to see Mr. Abbott of the Central Trust Company with reference to charging off this account, and he called me down out of the office. Our office, as I remember it, was in the Harris Trust Building, next door to the Central Trust Company. We then had some discussion, and it was Mr. Abbott's suggestion and mine that they might properly charge off their claim against the Cotta Transmission Company as a loss. I am not sure whether it was the New Departure Company, or not. As a bed debt, I don't know the difference, under regulations, between a loss and a bed debt. I was a bad debt. By "bad debt" I mean a claim against an estate in bankruptcy, on which he might possibly not get any dividend. If he got any dividend, it would be after long delay, and speculative. If we held the estate open long enough, it was hoped that the industry would pick up, and we might make an advantageous sale of the property, and we continued to operate with that idea in view.

I began active operation of this bankrupt estate before
76 the first of the year 1921. I certainly kept myself busy between Christmas and New Year. I remember that very distinctly.

I advised one of the creditors to charge off its claim against the Cotta Co. I gave this creditor this advice two days before New Year's day; that is my best recollection.

77 Upon Redirect Examination Fred E. Hummel testified as follows:

We found it not advisable to sell the property in the fore part of 1921 because we advertised it for sale either on March 8, or March 6, and got no bids. The dividends that I have referred to, were made possible by reason of the change in the general business conditions. The price that we got for the property, in my opinion, was brought about by the change in conditions.

Upon Recross Examination Fred E. Hummel testified as follows:

Referring to this balance sheet that we have been going over, it says here, "Due to officers and stockholders", some

$50,000, due to T. D. Reber and E. T. Reber; we pay such debts as that if they are allowed. Some times we object to them and find they are not proper claims, but in this case those claims were allowed. It is my recollection that the Messrs. Reber's claim was waived thereafter in consideration of some insurance policies that we permitted Mr. Reber to keep. Those claims were filed and allowed. At that time they had one year within which to file their claims, and now they have got six months.

The first official notice to creditors is after the adjudication. In this case we didn't send out the notices to creditors to make their claims, until after the first of the year 1921.

We send a notice to each creditor we find on the books
78 of a corporation, a postal card notice; that is, the official court notice is a postal card notice.

Thereupon, C. D. KELLY, having been first duly sworn, as a witness on behalf of petitioner, upon Direct Examination, testified as follows:

I am Chas. D. Kelly of Winnetka, Illinois. I am president of the La Salle Steel Company. I was connected with that company in 1920. I have been in this business since 1912. The affairs of the Cotta Transmission Company, of Rockford, Illinois, were brought to my attention in 1920, due to their financial condition. I was a member of the creditors' committee and did the following in co-operation with the other creditors, in investigatng the affars of the Cotta Company.

When the Cotta Transmission Company brought it to the attention of all of the creditors, that they were in difficulties, this committee was formed, and we got together and reviewed the entire situation as best we could, not only of the Cotta Transmission Company, but of the conditions in the industry generally affecting the Cotta Transmission Company. We not only found a hopeless state of affairs in the company itself, but in addition to that, and most important of all, from the creditors' standpoint, was the fact that the Cotta Transmission Company were manufacturers of truck transmissions, and the first thing we found was that practically all of their customers were either bankrupt, or in the hands of creditors' committees; that the customers weren't good
79 credit risks. We further found that the country was flooded with war-time trucks, that the Government was

disposing of; so that necessarily meant that the Cotta customers had no possibility of coming back; and we further found that, due to either manufacturing or engineering difficulties—which of the two I am not sure of—it looked very much like, if their customers did come back and did get on their feet financially, the majority of them would not do business with the Cotta Transmission Company, due to the fact that the transmission wasn't what it should be for peacetime purposes. So on that basis, the outlook was, from my viewpoint, absolutely hopeless.

I had come to the conclusion before the time of the filing of the petition in bankruptcy of the Cotta company as to the value of the general, unsecured claims against the Cotta company. I had come to the conclusion, before that time, that the claim was worthless, which was why we threw them into bankruptcy. It was based on the conclusion that, as good business, under the existing conditions, it was thought there was no possibility of it continuing as a going business. I participated in the attempt to get the suppliers of merchandise to that company to take it back. The attempts were absolutely unsuccessful. These transactions that I have testified to took place prior to the turning of affairs over to the Referee.

The automotive industry in 1920 was not only absolutely flat, but from the truck standpoint it looked like a hopeless situation for a good many years to come, due to two
80 reasons: First to the surplus of Army trucks, plus the fact that the opinion at that time was that the industry had gone too far in motorizing, and had adopted trucks in many cases where it was eventually going to be cheaper to go back to horses.

By Mr. Tyrrell: Q. As a man in the steel business in 1920 and for many years prior thereto, basing your judgment upon your investigation and as a member of the creditors' committee of the Cotta company made in the latter part of 1920, did you have any opinion as to what was the prudent business judgment for a general creditor to do with respect to any unsecured claim against the Cotta company?

Mr. Luce: I object, your Honor, as irrelevant, immaterial and incompetent, and calling for a conclusion.

Mr. Tyrrell: That is just the point: It is the conclusion of a business man, based upon his general business experience, and upon his practical experience with respect to his activities on this creditors' committee.

The Member: He may answer the question.

The Witness: It was my opinion it definitely should be charged off.

By the Member: Q. Did you charge yours off?

A. I did, your Honor.

By Mr. Tyrrell: Q. And do you now consider that such was the exercise of prudent business judgment?

A. I do.

81 Mr. Lace: I object to that. It is irrelevant what he thinks now.

The Member: That will be sustained.

Mr. Tyrrell: An exception. That is all.

Upon Cross-Examination C. D. Kelly testified as follows:

I was a member of this creditors' committee that was appointed there in the Fall of 1920. I am familiar with all of those facts and circumstances. With respect to an offer of citizens there at Rockford, there was either an offer, or a request to know what our opinion would be if the offer was made. I don't believe that it got any further than a request to know what the creditors' attitude would be, if they could make the offer. The creditors' attitude was that they would be tickled to death. I am sure of that. I was on this committee all of the time. I don't remember an actual offer being made. I stated we either were asked what our attitude would be, if they made the offer; or they made the offer, subject to their ability to come through with it. In any event, they got a favorable answer from the committee, and that was the end of it. To the best of my recollection the creditors absolutely did not say they must have at least 40 per cent.

I have absolutely no connection with this taxpayer. I have no interest in this proceeding, none at all.

82 Thereupon, LEIGH H. JACKSON, having been first duly sworn as a witness on behalf of the petitioner, upon Direct Examination testified as follows:

I am Mr. Leigh H. Jackson and live in Chicago. I am attached to the Credit Department of Joseph T. Ryerson & Sons. I have charge of certain credits and act as House Attorney. I have been connected with that company twenty-eight years. For fifteen years I had charge of the city and railroad credits. For the last five or six years, my time has been devoted entirely to the handling of legal matters and

the adjustment of claims. I am an attorney at law, admitted to practice. As I say, I am an attorney in theory, but not in practice. I haven't been in a law office for twenty-five years.

I had occasion to come in contact with the Cotta Transmission Company of Rockford, Illinois in the Fall of 1920. My people were creditors for quite a large amount and the company was in a bad way, and I made some investigation, and a creditors' meeting was called and I attended the meeting. I acted with the other creditors in making an investigation of the affairs of the Cotta Company. There was a creditors' meeting called, and at one of those meetings there was a creditors' committee appointed, and I was a member of that committee, and in that capacity I made quite an extensive investigation of affairs.

The first time I was at Rockford, on my return I reported that they were hopelessly insolvent. That was based upon my examination of the situation there; upon the condi-
83 tion of their assets and their liabilities. The committee were making a great effort to effect some compromise, or reorganization, or something of that sort, and there was quite a faction there in Rockford that tried to combine or raise capital enough to control the situation, and they did. We finally induced them to make the offer.

My own people agreed to accept 40 per cent for our claim, paid on or before December 15. That proposal did not go through; they defaulted on that date, but asked for a little additional time, and they were given another week's time, to December 23, in order to make good on the proposition. We were anxiously awaiting a decision on that compromise offer. We were very, very anxious to get the money, but they failed in their efforts to raise the money, they couldn't make good; and, thereupon, certain creditors filed a petition in bankruptcy I think on that same day. I mean the day of the expiration of the week's extension. I think they were prepared to file their petition immediately, because it was filed on that day.

The committee did not officially as a committee make any recommendation to the creditors as to what the creditors should do with their general, unsecured claims against this Cotta Transmission Company; but we spent a great many hours and days on that matter, and we talked a great deal. When this situation turned up, and the offer had fallen down, and the petition in bankruptcy had been filed, we certainly

did discuss the situation, and each member, I think, ex-
84 pressed himself very freely as to what he thought was the value of his claim. Our company, on my recommendation, charged off its claim in its entirety. I had charge of such matters at that time for our company. We charged it off, as of December 31, 1920, the end of the year.

This conclusion of mine was based upon my previous examination of the debtor's condition and situation, and the negotiations of the creditors' committee. I had been to Rockford, I had looked over the plant, examined the plant, examined these statements, knew the condition of the automobile trade; I knew the customers they were selling, most of them had fallen down, out of business, or bankrupt, or something. There was fault found with the management out there. The device they were putting out wasn't what we call "fool proof," it wasn't perfect, in our opinion; and every effort to reorganize or carry on that business had fallen down; and it looked as though there was nothing but a forced bankruptcy sale in sight for us, as all efforts to sell or reorganize had fallen down. I felt very much discouraged, and told my associates I didn't believe we would ever get one cent out of bankruptcy, and the other members of the committee felt the same way; and those people who asked us for advice were given our opinions. We didn't go out peddling advice, but if anyone asked our opinion they got it freely. The members of the committee, of which I was one, we discussed the situation freely; and as a whole, we thought our claims at that moment seemed just about hopeless.

85 I was not influenced in any way by a tax consideration, in charging off this claim; taxes were entirely foreign to my department; I knew nothing about the tax situation. At the time of the filing of the petition in bankruptcy, I thought the Cotta company was hopelessly insolvent. At the close of 1920 I considered it the exercise of prudent business judgment for the general creditors to charge off their unsecured claims against the Cotta company, absolutely.

I never heard of the federal taxing authorities making any objection to the deduction of that claim on its income tax return by our company. The dividends that were subsequently received were treated as additional income for the current year. Whatever was done with it as a tax proposition, I don't know; that is outside my province.

Upon Cross-Examination L. H. Jackson testified as follows:

It was not a citizens' committee of Rockford that en-

deavored to raise this money; the nucleus of it was the creditors, a lot of the Rockford creditors, and they were trying to work up a public sentiment out of it, trying to get people to subscribe money to save the industry for the town, and so on, an opportunity to buy something cheap and keep it going. I never met with that committee; I never saw their line-up, but in a general way that was what they were. They were a town committee, mostly creditors. I think that they at first made an offer of 33-1/3 per cent. Our committee was jockeying with the buyer, trying to get him up, naturally, in
86 the interest of a lot of creditors that were going to suffer sufficiently. We dickered on the thing. I couldn't tell you whether they made a positive offer of 33-1/3 per cent, or not; but I am quite sure they didn't, because I believe we would have agreed to it. We bargained over a considerable period. My firm didn't sign any petition in bankruptcy. I don't know what firms signed the petition in bankruptcy. I knew at the time but I have forgotten. I never saw the petition.

I think our committee all had a desire to carry the thing along further, with the hope that we might work something out of it, you know; might find a way to dispose of this property, without going through the slaughter that naturally follows bankruptcy. I think that was the general opinion of the committee. The committee was of the opinion that they should keep this plant in operation only in a limited way. There is an object in keeping it going, because there is a demand for repair parts, and you can work up some of these materials and dispose of a lot of stuff and convert it into money, which is one reason; and another reason is, if you can keep the wheels going around, you know, you can usually sell a live horse at a better price than you can a dead one, and that was the theory.

I don't know whether the plant ever shut down. I wasn't at Rockford only on two or three special occasions, when I went down there to visit the plant. I don't know whether they shut down, or not.

Our firm received two dividends; the first one was in March,
87 1922, of 15 per cent; and the next one came in the following year, 1923, and was 12½ per cent. I was not in favor of forcing a sale in December, 1920, of the plant, because conditions were so terrible. The town out there had several plants that were looking for buyers. We sought every possible prospect we could find in the endeavor to get

somebody to nibble at it; and the general trade conditions, and especially in the auto and truck business, at that time, were so bad that I, personally, was of the opinion that it would be better to hold it; and there were others that thought the same way. Wait for conditions to improve so as to get a better price for the assets.

It is a large plant, one of these big, ungainly plants, and it is very hard, indeed, to get a buyer for such a plant. Anyone that wants to buy a plant of that character can buy it at their own figure, because buyers are so few.

It finally sold for $175,000; that was for all the assets, outside of the accounts receivable and cash. In looking up some of my old records there I see that on December 15, 1923, all the assets except the accounts receivable and cash were sold to P. E. Swantz, representing a Rockford syndicate, for $175,000. That is all the assets, separated from the accounts receivable and cash. I do not know how much cash was on hand at that time, nor what the accounts receivable amounted to in December, 1920. I went over those accounts receivable with the other members of the committee, and the cream of them had been assigned to the banks; and the remaining accounts that were not assigned, were almost a worthless bunch. They were against several large accounts, but against 88 concerns that were themselves insolvent.

Upon Redirect Examination L. H. Jackson further testified:

When I answered the questions of the government's attorney about the sale of the property there, I took that memorandum off from a claim docket which is one of the records of my company. There was a notation in my own handwriting on that claim docket to the effect that the property was sold, that all the assets were sold, except the accounts receivable and cash, to P. E. Swartz for $175,000. I made the notation on that paper. The first entry on this page to which I have referred in refreshing my recollection as to this matter,—the first two words on that page were "Hopelessly insolvent." They were in my own handwriting. I made that entry in November, 1920.

I have no specific recollection of that particular report, Exhibit 6; but I was on that committee and I was active, I was looking after everything of that kind. I certainly saw that report. I have a general knowledge of having examined some report.

The petitioner offered in evidence a report of examination

prepared by Arthur Young & Company; marked for identification as Exhibit No. 6, as part of the report brought before the creditors' committee, and which served as part of the basis for its conclusion in respect to the Cotta Transmission Company. Said document so offered and received in evidence was marked "PETITIONER'S EXHIBIT NO. 6", and made part of this record.

89 HOWARD C. GREER, having been duly sworn as a witness on behalf of the petitioner, upon Direct Examination testified as follows:

I am Howard C. Greer. I live in Winnetka, Illinois. I am an Accountant with the Institute of American Meat Packers in Chicago. I am a Certified Public Accountant. I was connected with the firm of Arthur Young & Company in the year 1920, in the capacity of an Accountant. During that year I had occasion to examine the books and records of the Cotta Transmission Company at Rockford, Illinois. Exhibit numbered 6 is the report which I made as the result of my examination. I was a Certified Public Accountant at the time I made this examination. I prepared this report. The firm made the audit for the creditors' committee. I can't state, of my own knowledge, the purpose of the audit.

Arthur Young & Company were requested to make the audit, and I was assigned to do the work as the reserve man of the firm. I was in charge of the audit. We were about a week on the job, I should say, and it took perhaps two or three days after that to prepare the report. The report is dated October 25, and was as of October 15; so that only ten days elapsed between the effective date and the date when the report was rendered.

The valuation of inventories is an estimate based on such information as was available to us, the cost records of the company, the average percentage of cost of sales for the first eight months of the year, and certain information as to
90 purchases of materials, sales of goods, and so on. We took, as a basis for our estimate, the books and records of the company as they were at that time, and based our estimate upon the previous cost records of the company. The company ceased keeping cost records August 31, 1920. We projected our estimate forward for the forty-five days between August 31, 1920, and October 15, 1920, on the basis of

what had happened during the preceding eight months of that year. The report states that the estimated cost of sales was 108 per cent of the sales. I will read our paragraph under the head of "Inventories":

"From its cost records the company had arrived at an estimate of inventory at August 31, 1920, but no later figure was available, owing to the abandonment of cost keeping after that date. The manner of handling the cost records makes it impossible at the present time to arrive at an accurate statement of inventory values, without a physical inventory. In order, however, to present a complete statement for balance sheet purposes, we made an estimate based on the results of operations for the first eight months of 1920, taking into consideration the actual purchase of materials, the productive labor, and the overhead expense, the physical inventory value as of January 1, and the book inventory of August 31. These figures indicate the cost of sales for the eight months of approximately 108 per cent. Also similar costs for the remaining forty-five days to October 15th were arrived at. We arrived at the amount of $507,080.36 as the probable value of the finished goods, work in process, raw materials and scrap, at the later date. A physical inventory of the bar steel and scrap iron on hand, priced and extended by the company's staff, indicated their values to be $54,456.14 and $5,775.00, respectively; a balance of $46,849.22 being set up as finished parts and work in process."

91

This statement, which I have just read, in my opinion, correctly states the situation. Plant assets and non-operating property are stated at the values appearing in the books. We understood these represented the cost prices, but made no verification of this. In the computation of these values, we made no allowance for obsolete parts.

Upon Cross-Examination Howard C. Greer testified:

I was a certified public accountant in 1920, at the date I made this report. I passed the examination in May, 1920, and the certificate was awarded to me in September, as I recall it. At the time that I made this investigation I suppose I knew the purpose of making this audit, in a general way. I was undoubtedly informed by my superiors as to why we were making the audit. I could tell now from the audit in a general way why it was done, and what the purpose was, but I hesitate a little to try to express any opinion of my own knowledge. I knew that my report would be presented to the creditors' committee and that it was being made because the

company was obviously in financial difficulties, and the creditors wanted to know where they stood as nearly as could be determined from a hasty checking of it.

92 In some respects it was a careful investigation; in others, it was a very hasty and superficial examination. I assume the haste was because the creditors felt they needed to act promptly to protect their interests. We were requested to make a rapid investigation. We made qualifications in the report; I think they are rather completely stated there. It is not a certified statement of the financial position, it is merely a presentation of certain facts obtained hastily from a superficial examination of the records. That is all it purports to be, and that is all we were asked to do. I could specify more particularly in what respects we were careful, and in what respects we were hasty.

We were very careful to determine, as fully as we could, all of the liabilities and obligations of the company; we made a very careful effort to see that those were all included. With respect to the valuation of the assets, we were much less careful, and merely took them, as you might say, at their face value, intending that those valuations should be taken with such qualification as the creditors themselves might see fit to apply to them. We were careful with respect to the liabilities, and not so careful with respect to the assets, because that is a somewhat common procedure, when an accountant is asked to make up an investigation under these circumstances: the creditors want to know what the liabilities are, what their companies were up against and in a way of what they had to meet, because that is definite and can be learned and there is no question about the amounts. In respect to the as-

93 sets, their values depend a great deal on the future course of the business of the company. If a concern continues to operate as a going concern, and pursues its business in the ordinary course, they might presume to—they might expect to obtain certain values for their assets; and if it were to liquidate or discontinue its business, the values of those assets would be totally different. Our valuation was placed on the assets on what you might call a liberal estimate of going-concern values.

The customary rule that is applied by accountants is, that an inventory, for example, shall be valued at cost or market, whichever is lower, as of course you are well aware. In the case of fixed assets, they are customarily valued at original cost, with allowances for depreciation, and so on. If times

are such that values have decreased, that may affect the inventory, probably, for the fixed assets. We made no allowance in our estimates here, or investigation, for any diminution in values due to declines in commodity prices, and so on.

We did not arrive at those inventories on the basis of cost or market, whichever was lower. The method that we used, is outlined in the report. We merely adopted the presumption or assumption that the goods sold had the same relationship in value to their sales price as had existed during the first eight months of the year, as nearly as they could be determined, projected that assumption forward through the
94 remaining forty-five days, and made no allowance for decrease in values, obsolescence, or anything of that sort.

MRS. HELEN KENDALL, having been duly sworn as a witness on behalf of the petitioner, upon Direct Examination testified as follows:

I am Mrs. Helen Kendall, formerly Miss Helen Grundman. I live at Waukesha, Wisconsin. I am connected with the Spring City Foundry Company, the taxpayer in this proceeding. At the present time I am assistant treasurer and manager of the office. I was connected with that company in 1920. I first started with the company in 1916. In 1920 I was bookkeeper and stenographer; I did all of the office work. I was the only bookkeeper the company had in 1920.

There are in court here the books and records and accounts of the Spring City Foundry Company for the year 1920. We have the journal, the general ledger, the pay roll books, and cash book. The entries in these books for the year 1920 are in my own handwriting, and were kept by me in the regular course of business. The entries were made contemoraneously with the transactions which they attempt to record; that is, they were made at the same time, or shortly thereafter, in the regular course of our bookkeeping practice. These records correctly show the transactions which they purport to show. The journal which I have referred to, was the original book of entry of the company at that time.

Ledger sheets, exhibits Nos. 11 and 12, are the original
95 ledger sheets of the Cotta Transmission account for the latter part of 1919 and 1920. Documents marked No. 13 and No. 14 for identification, are copies of the original ledger sheets which have been referred to as Nos. 11 and 12. (Ex-

hibits 11 to 14 were admitted in evidence and by consent the copies, Exhibits 13 and 14, were substituted for the originals, Exhibits 11 and 12.)

On the reverse of exhibit No. 11, are some pencil marks, balances inserted on the account in certain places; they indicate that the account was balanced up to the end of February.

This ledger sheet is a complete statement of the account with the Cotta Transmission Company during the year 1920, with the exception of certain promissory note transactions. These sheets, however, show the receipt of all of the promissory notes in question. The ledger account commencing with the credit entry of April 19, 1920 means that we received a note between April 17th and April 19th for $5,600.00 from the Cotta Transmission Company in part payment of the account. That was credited to their open account. Other notes were, from time to time, credited upon this account. (Exhibits 16 to 20, inclusive, were admitted in evidence. They are the original notes received by the Spring City Foundry Company during the year 1920, signed by the Cotta Transmission Company. By consent EXHIBIT NO. 21 was received in evidence as a true and correct copy of said original notes).

There were no other payments on account of this ac-
96 count against the Cotta Company, except those credited upon these ledger sheets. With respect of the first note received of $5,600.00, I am referring to the journal entry of the receipt of that note at page 33 of the journal, which has been marked for identification as exhibit 15. On April 19, we debited cash and credited Cotta Transmission Company, and in the remarks column, "90-day note, 6%, April 17, $5,600.00." The credit is under the column "Sundries", and it was credited direct to the Cotta Transmission account. This note was debited to cash, because it was discounted immediately upon its receipt. We kept no separate record of the discounting of notes. This note was discounted with the Waukesha National Bank.

By referring to exhibit No. 9, being one of the original ledger sheets of the bank I have referred to, I find under date of April 17th a record of this discount. The entry is,—April 17, Cotta Transmission Company, #4336; under Rate column, interest, 6; under date due, July 17, 1920; debit of $5,600.00, as indorser. The $5,600 appears under the column "As indorser". This ledger account bears at its head—

"Spring City Foundry Co., Waukesha, Wis." On that day this note was discounted.

By referring to this same exhibit 9, I can state that that note was renewed on July 21 for the full amount of $5,600. This renewal note was deposited with the bank in exchange for the note of the same amount then due. That was the Cotta Transmission Company's note, and the same amount is entered here under "As indorser", $5,600.

97 Exhibit 22 is the separate record that we keep of notes receivable. We commenced keeping this record July, 1920. This $5,600 note was again renewed on August 19. The date in the left-hand column is August 4; that is the date we received the note indicated here. That note, received on that date, is a renewal of the note dated July 20. It is for the same amount. This note was for 15 days. That note was again renewed under date of August 19, the date that it fell due, for four months, and for the same amount, $5,600. At the respective times that this note was renewed, the renewal notes were deposited at the bank to replace the note that had expired. This note as extended for four months, for the same amount, became due four months after August 19, or in December. During all that time, that note was discounted and in the possession of the bank.

The next note was dated May 18, amount $5,300.00, for 90 days; due May 18. It was credited upon open account. Exhibit No. 9 shows the discounting of this note for $5,300.00 on May 18. This appears upon the same account under the liabilities of the Spring City as indorser. Our journal entry of that item is May 19, debit cash and credit Cotta Transmission Company; in the remarks column, 90 day note, 6 per cent, May 18; in the cash column, $5,300.00; and in the sundries column, $5,300.00.

The reason this was debited to cash was because we received the cash proceeds upon the discount at the bank.

The next receipt of a promissory note was on June 21, $5,100.00. Our journal entry of that transaction was

98 June 21, debit cash, credit Cotta Transmission Company; remarks column, 90 day note, 6%, June 19; cash column, $5,100.00; sundries column, $5,100.00. This note was likewise discounted. That is the reason the debit item is "cash". It was discounted at the same bank. Exhibit No. 9 shows the discounting of that note of $5,100.00 on June 19. The $5,100.00 appears as a debit under the indorser column of this account. The note record exhibit No. 22, shows that the note dated May 19, for $5,300.00, due about August 18, was

renewed on August 18, for four months, falling due December 18. Our "Remarks" column indicates that this is a renewal of the note due August 18, 1920. The same record, under date of September 18, shows that the note of June 21, for $5,100.00, was renewed by a note in the same amount due December 17. These two notes were substituted at the bank for two similar notes.

The next note received on the account was July 15, $9,300.00. The bank records show an entry dated June 15, Cotta Transmission Company, $9,300.00 for the discount of that note. That note was for ninety days. Our journal entry of this item shows: July 15, debit cash, credit Cotta Transmission Company, remarks 90-day note, 7%, July 13, cash column $9,300.00, sundries column $9,300.00. This note was likewise debited to cash because, on the same day, it was discounted at the bank.

The next item of a promissory note is August 18, $6,990.00, a note for four months. Page 71 of our journal shows:

99 August 18, debit cash, credit Cotta Transmission Company; remarks column, 4 months note, 7%, due December 16, 1920; cash column, $6,990.00, and sundries column, $6,990.00. This entry was likewise debited to cash by reason of the discounting of the note. Exhibit No. 22, being the note record, indicates a renewal of the $5,100.00 note under date of September 18.

These five notes that I have referred to were never paid by the Cotta Company. They were not secured in any way. They were discounted with the bank in the ordinary way. The balance due on the open account at the close of December, 1920 was $7,693.27. For the purpose of convenience, with reference to this open account, I have prepared a separate summary of the items making up the open account, Exhibit 23. I have, likewise, for convenience, prepared a summary of the items due under the promissory notes, showing the renewals, Exhibit 24. The notations at the right of three of these items correctly indicate the renewals of those promissory notes, and, likewise, the memorandum at the bottom states the renewal of the note referred to there. This exhibit correctly states the total of the principal of the five notes in question as being $32,290.00. There is appended to this a statement of the balance due on open account of $7,693.27. Exhibit 23 is a correct statement of the balance due on open account. The total of the principal due on the notes and the open account is $39,983.27; it is correctly set forth on this exhibit 24. This total represents the total principal of

the claims of the Spring City Foundry against the Cotta Transmission Company at the close of 1920. That item
100 was included in the gross income of the taxpayer, the Spring City Foundry Company, on its tax return for the year. These claims, or any part of them, against the Cotta company, were not secured in any way nor were they protected by insurance, nor protected in any way other than as general unsecured claims." (EXHIBITS 23 AND 24 were received in evidence).

Mr. Tyrrell: Will counsel stipulate that the entries upon the following journal pages of the book marked for identification No. 15, which entries have been read by the witness as the original journal entry of the receipt of these five promissory notes, be considered as evidence of the entry of those transactions, such pages being 33, indicating the journal entry of the receipt of note for $5,600 on April 19, 1920; page 42, indicating the receipt of the note for $5,300.00 under date of May 18, 1920; page 52, under date of June 21, noting the receipt of the note for $5,100.00 of the Cotta company; page 60, under date of July 15, 1920, noting the receipt of the note of $9,300.00 of the Cotta Transmission Company; and page 71 noting the receipt, under date of August 18, 1920, of note for $6,990.

Mr. Kiley: We will agree to that.

Mr. Tyrrell: In view of counsel's stipulation, we will not offer in evidence the pages indicated, all of the pages being in this journal marked for identification exhibit No. 15.

Witness: This unpaid balance due from the Cotta Transmission Company at the close, or about the end, of 1920 was charged off. I received instructions to charge this ac-
101 count off from Mr. Blair. The original journal entry of this charge-off appears in the journal here in court, marked for identification 15. I am referring to page 94. This entry is: December 28, charged to profit and loss, credited to notes receivable; in the remarks column, Cotta Transmission Company notes, $6,990.00, $9,300.00, $5,300.00, $5,100.00, $5,600.00; "said firm having gone into the hands of a receiver on December 23, 1920", $32,290.00 in the debit side of the sundry column, and $32,290.00 on the credit side of the sundry column. This entry was made December 28, 1920. I made a charge-off with reference to the open account. It is in the same journal, and on the same page. The entry is: December 28, 1920, debit profit and loss, credit Cotta Transmission Company account; in the sundry column, by balance due on

Cotta Transmission Company account; the sundry column, debit side, $7,690.37; sundry column, credit side, $7,693.27.

Exhibit No. 14, being the ledger account of the Cotta company, shows the charge-off. It was entered on December 28, 1920. Charged to profit and loss, page 94, $7,693.27. The ledger sheet headed, "Notes Receivable" is the ledger account of the notes receivable, the ledger sheet. This indicates the charge-off of the notes in question under date of December 28, 1920, in the amount of $32,290.00. The remark is "Charge to profit and loss". These notes were never renewed after these December maturities. We never took any new notes in December in exchange for these notes. They 102 were repurchased by the Spring City Foundry Company from the bank where they were discounted. We gave the bank our note in place of them, but one note we bought back for cash. On December 21, we gave the bank our check No. 25,546 for $6,990.00, in payment of one Cotta note. That was in payment of one of the Cotta notes that was discounted at the bank.

Upon Cross-Examination Mrs. Helen Kendall testified:

The first note, due 10/13 for $9,300.00 doesn't show on this note record, because at that time we hadn't started the note record. We started the note record on July 29, 1920.

Page 90 of the journal shows what happened to the July 13, 1920 note. The entry shows: November 23, 1920; debit notes receivable, and credit bills payable; Cotta Transmission Company note, $9,300.00, dated July 13, 1920, due October 13, 1920, taken up from Waukesha National Bank; $9,300.00 in the debit side of the sundry column, and $9,300.00 credit side of sundry column.

By debiting notes receivable, I mean we received back into our possession the note receivable. And by crediting bills payable, I mean that we credited our liabilities to the bank to that extent.

The Cotta company didn't take up the note when it was due, and it was up to us to take care of it, so we gave the bank our 6 mos. note on November 23, 1920, for $9,300.00 as maker. That is taken from the bank's record, exhibit No. 10.

The next note, $6,990.00, that was actually taken up by 103 us from the bank when it fell due in December.

Upon Redirect Examination Mrs. Helen Kendall testified:

Page 94 of the journal, marked for identification No. 15, shows that all of these notes, except the $9,300 note, charged to notes receivable and credited to bills payable under date

of December 28, 1920. That means we took back the notes from the Waukesha National Bank and gave them our notes in place. The notation under "Remarks" is "Cotta Transmission note dated August 18, 1920, $5,300.00, due December 18, 1920; Cotta Transmission note dated August 19, 1920, $5,600.00, due December 19, 1920; Cotta Transmission note dated September 18, 1920, $5,100, due December 17, 1920, taken up from Waukesha National Bank, a total of $16,000 in the sundry column on the debit side and $16,000 in the sundry column on the credit side."

On the same page 94, there appears an entry under date of December 21, 1920, notes receivable debited, credited cash, remarks Cotta note due December 16, 1920, Waukesha National Bank, check No. 25,546; sundry column, debit side, $6,990.00; cash column on credit side, $6,990. This shows that we took the Cotta note back from the bank and paid the bank the amount of it. So that with respect to the $6,990.00 note, we took that up and paid the bank the cash for it.

When the other four notes fell due, the other four notes being set forth on this summary marked No. 24, when they fell due, we took them up from the bank and gave the bank the notes of the Spring City Foundry Company for the
104 same amount, or the same totals. (Exhibit No. 24, being a summary of items due from Cotta Transmission Co. was received in evidence and marked "PETITIONER'S EXHIBIT NO. 24"). That is the $5,100 note and the $5,300 note and the $5,600 note were totaled and given to the bank as one note, $16,000, and the bank got a note of $9,300 to take up the other $9,300 note. The $9,300 note was given on November 23, 1920, and the $16,000 on December 28, 1920. And those were the respective dates upon which we took up the notes from the bank and replaced them with our notes.

Exhibit 26 shows the ledger entries of the transactions with respect to the taking up of these notes from the bank, about which I have testified in referring to pages 90 and 94 of the journal. (EXHIBIT 26 was, with the consent of counsel, received in evidence as a true and correct copy of the notes receivable ledger record, the original of which had been identified as exhibit 25). (EXHIBIT NO. 30 was, with the consent of counsel, received in evidence as a true and correct copy of the original profit and loss sheet, which original had been produced in court and identified as No. 29). Exhibits 29 and 30 show that the items of this Cotta account were debited to profit and loss. December 28, 1920, Cotta Transmission note, journal page 94, $32,290.00; December 28, 1920,

Cotta Transmission account, journal page 94, $7,693.27. Those are the debit entries on this account. They were 105 made on the date indicated, December 28, 1920. (EXHIBIT 27, being the original bills payable ledger account of taxpayer, was, with consent of counsel, received in evidence). Exhibit 27 shows our notes which were given to the bank when we repurchased the past due Cotta notes which we had discounted there. (With the consent of counsel EXHIBIT 28 was received in evidence as a true copy of journal page 94 and also one entry from journal page 90.) (With the consent of counsel a document entitled "Audit for year ending December 31, 1920, Spring City Foundry Company," upon the heading of Marwick, Mitchell & Company, Accountants and Auditors, was received in evidence as EXHIBIT 31.) (A similar audit report for the three years ending December 31, 1919, prepared by the same firm of Accountants, was upon consent of counsel, received in evidence as PETITIONER'S EXHIBIT NO. 32.) (The original return of taxpayer for 1920 was received in evidence as joint EXHIBIT B-33, and the amended return for 1920 was received as joint EXHIBIT C-34.)

(It was stipulated by counsel that the taxpayer received, on or about March 24, 1922, a dividend in the bankruptcy proceeding of the Cotta company of $6,145.91 and a similar dividend, on or about January 3, 1923, of $5,121.60 and that, on the books of the taxpayer for those respective years, these items were included as part of the income, and were also reported as income on the income tax returns for such years. Further, that the Commissioner allowed the $39,000, odd, involved here for 1920 as a deduction from income in 106 1923, less the amounts collected as dividends in 1922 and 1923; that the amended return of the taxpayer for the calendar year 1921 shows a net loss of $27,056.38; that the return for the year 1922 shows a net income of $4,855.28; and the return for the year 1923 shows net income of $1,705.84.)

(A certified copy of the petition in involuntary bankruptcy of the Cotta Co., verified December 20, 1920; together with a certified copy of the order of adjudication in bankruptcy, dated January 20, 1921, with consent of counsel were received in evidence as EXHIBIT 35.)

(With consent of counsel, a summary of the Cotta Transmission Company's schedules filed in the bankruptcy proceeding was received in evidence as EXHIBIT 37.)

(With the consent of counsel, the taxpayer's note record was received in evidence as EXHIBIT 22.)

Witness: If there had been any renewals of these notes, they would have been disclosed by our note record, exhibit No. 22. Exhibit 22 shows all the receipts of notes, including the renewal notes, during the year 1920, subsequent to the commencement of this record under date of July 28, 1920.

Mr. Tyrrell: To clear up any possible uncertainty as to exhibit 37, this is submitted as, and has been identified by the witness as, a true copy of the summary of the debts and assets appearing on the schedules of the Cotta Transmission Company.

107 (Upon stipulation of counsel, EXHIBIT 38 was received in evidence as a correct statement of the salaries and stockholdings of the officers of taxpayer.)

Mr. Tyrrell: I now propose to show that, commencing with the year 1916, the company was indebted to a stockholder by the name of C. A. Haertel on the note of the company for money borrowed from that stockholder in the sum of $2,500.00; that such loan and indebtedness of the company to Mr. Haertel continued until April 30, 1920, as shown by the payment on that day of $2,500.00, as set forth on exhibit 27.

I also propose to show, by refernce to the original records, that commencing with May 11, 1917, the company was indebted to the same stockholder for a loan from him to the company upon the company's note in the sum of an additional $2,500.00, and that such liability continued for borrowed money until August 11, 1920, at which time it was paid in full. This payment is likewise set forth on exhibit 27. By referring to exhibit 27—

Mr. Luce: Now, I will agree to that, if you want me to, if it will save time. Instead of going all over that again, I will agree to it. I think the record speaks for itself.

Mr. Tyrrell: That is satisfactory.

Witness: Mr. Blair and Mr. Reichl ceased having active connection with the management of the Spring City Foundry Company in 1927. It was either the latter part of July, or the early part of August. That was about the time that Mr. Grede took over the majority stockholdings in the com-

108 pany. Up to that time, Mr. Blair was president and treasurer and in charge of the office. Mr. Reichl had charge of the shop. After their departure, Mr. Kreulen took Mr. Reichl's place, and in the office we put on four more girls, and Mr. Arthur L. Grede. Mr. Arthur Grede devoted all of his time to the affairs of the company. Mr. William Grede commenced devoting about half of his time to the affairs of

the company. It required the services of the aforementioned people to perform the work that had previously been performed by Mr. Reichl and Mr. Blair.

Mr. Tyrrell: Is counsel prepared to admit that the statutory net income, as now determined by the Commissioner, is $119,017.36?

Mr. Luce: Is that shown on the thirty-day letter?

Mr. Tyrrell: It is shown on a letter; I do not just know which letter it is. As set forth in my opening statement, your Honor, the computation by which the Commissioner arrived at the deficiency here in question was set forth in this letter, which was referred to through a series of two or three letters, ending with the last letter called the sixty-day letter. I have here the letter of October 14, 1925, directed to the taxpayer, signed by the Supervising Internal Revenue Agent at Milwaukee, Wisconsin, to which is attached the computation of the revenue agent in respect to the year 1920 of this taxpayer; together with copy of a letter of November 27, 1925, likewise directed to the taxpayer, from the same source, to which was attached one sheet of tabulation, being a supplemental
109 computation based on the earlier computation as transmitted with the letter of October 14, 1925. This copy of the computation accompanying the letter of November 27, 1925, has been certified by the internal revenue agent at Milwaukee, Wisconsin, as being a true copy of the letter originally sent out—that is, a true copy of the computation sent out,—in these words: "The above is a true copy of the revenue agent's supplemental report dated November 20, 1925," and signed, "John J. Stier, Internal Revenue Agent."

I understand that counsel agrees to the admission of these documents in evidence, and I wish to offer them.

Mr. Luce: No objection. The respondent agrees that the statements set forth in these letters are the final determinations of the respondent, as shown by this series of letters.

Mr. Tyrrell: Inasmuch as they are bound together by a rather permanent fastener, I think they may be received as one exhibit.

The Member: They will be received as petitioner's exhibit 41.

(Said document so offered and received in evidence was marked "PETITIONER'S EXHIBIT NO. 41", and made part of this record.)

Mr. Tyrrell: By referring to this exhibit 41, I just wish to call attention to the fact that the statutory net income as determined by the Commissioner is $119,017.36; that the

statutory invested capital, according to such computation, is $157,438.13. I call attention to that because we have prepared, for the sake of convenience, a statement of the ratios, which I propose to substantiate by certain of these undisputed
110 figures; and in that connection I wish to show to the witness a document marked for identification exhibit 39.

I also wish to state, with reference to this exhibit, that exhibit 41 discloses that the profits tax is computed at $38,190.41, and the combined income and profits tax at $46,073.11; that all of the figures set forth in the caption of this statement have been thus verified, with the exception of the salaries and average borrowed capital, which I shall do presently.

With reference to exhibit 40, we submit this as our computation, based on the facts in evidence, of the ratio of current assets to current debts.

Mr. Luce: I have no objection to that as such, your Honor. Of course, I am not agreeing that those figures are correct, but I have no objection to the offer by the taxpayer of his computation, his basis; but I am not agreeing, I want it understood in the record, to the correctness of all of those figures. I think undoubtedly some of them are correct, but I do not want to agree to them all. I have no further objection to the offer.

(PETITIONER'S EXHIBIT 40 was received in evidence as the petitioner's computation of the ratio of current working assets to current debts.)

Witness: The figures on Exhibit 40 were taken off of the audit report for the year 1920 and they correctly set forth the figures as disclosed in that report. This $11,267.51 didn't show on our audit report, because it wasn't received until 1923 from the Cotta Transmission Company.

111 Thereupon, HENRY E. BLAIR, who had previously been sworn and had testified, was recalled on behalf of the petitioner, and was examined and testified as follows:

Direct Examination.

These promissory notes of the Cotta Company were taken by the Springe City company in payment of, or as evidences of, indebtedness due on open account. None of them were secured in any way. When they were deposited with the bank

when discounted, they were indorsed by the Spring City Foundry Company, and payment guaranteed by the Foundry Company on each one. The Spring City company remained liable for the payment of those notes, in the event the maker didn't pay them.

I heard the testimony of Mrs. Kendall with respect to the taking back of those notes by our company. It is correct that all of these notes, totaling $32,290.00, were taken back by the Spring City Foundry Company. They were either paid for in cash at the time, or notes of the Spring City company given to the bank in payment therefor. Such notes of ours were ultimately paid by us to the bank.

Mr. Tyrrell: I show you documents admitted in evidence as exhibits 8, 9 and 10, which you have previously identified as being original bank records; and I also show you exhibit for identification No. 42, and ask you if you have compared the figures set forth on this exhibit 42 with the figures relating to the same transactions as set forth on these original bank records?

112 Witnes: Yes, sir; we compared the two and they agreed.

Mr. Tyrrell: I offer in evidence EXHIBIT 42 for identification, as a statement of the direct liability of the taxpayer to the bank on the respective dates set forth on the exhibit, also the indirect liability by reason of the discounted paper called here "Two-name paper", also showing the indebtedness to the stockholders during this period, which latter items have been admitted by counsel. I offer that document in evidence.

Mr. Luce: I have no objection to this document as a list representing the notes, or showing the notes of this company, payable to the bank and to the stockholders, and the statement of the discounted paper of this petitioner; but I do not care to admit the liability of the petitioner on all of these amounts as a statement of the petitioner's liability for this one period, because that involves a question of law and I do not know how far it may go. But I am perfectly willing that it shall go in for what it is: A list of the money borrowed, and a list of the discounted paper.

Witness: The figures set forth in the column under the heading, "Bank", show the amounts of the promissory notes given by the Spring City company to the bank for borrowed money; those are the direct notes of the Spring City Foundry Company to the bank. The figures set forth in the column un-

der the heading, "Two-name or discounted paper", consist of the amounts of the notes of other persons payable to our company and discounted by us with the bank. All of these notes were indorsed in the manner I have previously de-
113 scribed. None of such notes bore the caption "Without recourse". These figures also include the notes of the Cotta Transmission Company, except that the last month or two months we had taken some of them up at that time. They then show in our direct note, when we gave our direct note to the bank and took up some of the Cotta company's notes.

Mr. Luce: No objection to that offer on that basis, your Honor.

The Member: They may be received as petitioner's exhibit 42.

(Said documents so offered and received in evidence were marked "PETITIONER'S EXHIBIT No. 42," and made part of this record.)

By Mr. Tyrrell: Q. I now show you exhibits 8, 9 and 10, being these bank records; inasmuch as we will request to have these bank records withdrawn, will you kindly state what the records show with respect to the name of the company signing the notes which you discounted? Will just ask you to read the various names.

A. They show that these notes that we discounted were taken some from the Cotta Transmission Company, some from the Waukesha Motor Company, and the Wisconsin Motor Manufacturing Company. I think those are about the only three firms that we took notes from, except the Liberty Motor Company. Those were surely the only ones that we had notes from, and my recollection is they were about the only firms we took notes from.

(Exhibits 8, 9 and 10, they being bank's records, were withdrawn with photostats to be substituted.)

114 Witness: We found it necessary, for the purpose of conducting our business during the year 1920, to have the use of the money obtained in the discounting of this paper. Our invested capital was not sufficient, during that period, to enable us to conduct our business without loans. We were never a party to a cost plus contract with the Government. None of these notes of the Cotta company, which were left in our hands after we took them back from the bank, were ever again renewed by the Cotta company. I know that to be a fact.

I performed services for the company during the year 1920,

in addition to the usual duties of a president and treasurer. I was the manager of the office end of the business. I was interested in purchases and sales. Mr. Reichl looked after purchasing most of the supplies outside of the office supplies, and the sales, he attended to most of the sales. I had charge of the credits and collections. Mr. Reichl was superintendent of the foundry and looked after the purchasing of supplies for the foundry. He was the practical foundry man for the company. He acted as superintendent of the foundry. We had a foundry foreman, and a core room foreman and a cleaning room foreman, and had other minor foremen under them in the different departments. We had no general foreman. We had no one in the general maangement of the business, other than myself and Mr. Reichl. We both devoted all of our time to the company. We didn't think our salaries were adequate for the services performed, in comparison with the work done. However, we had grown up from a small
115 plant and didn't feel like demanding too much money until the plant got to making more money. A reasonable salary for the services performed by me during 1920 for the taxpayer, if performed for another company of the same kind in which I had no stock interest, would be anywhere from $10,000 to $12,000.

Mr. Tyrrell: In connection with counsel's earlier admission that the application for special assessment was denied, I just want to ask him if he cares to supplement that to say it was denied upon its merits; that is, that it was considered upon its merits, and denied upon its merits?

Mr. Luce: Why, I presume it was denied and on its merits after a careful consideration. I assume it was denied after most careful consideration.

(With consent of counsel copy of "Iron Age" was received in evidence as EXHIBIT NO. 7.)

WILLIAM J. GREDE, called as the next witness on behalf of the petitioner, after being first duly sworn, was examined and testified as follows:

Direct Examination.

I am Mr. William J. Grede. I live in Wauwatosa, Wisconsin. I am now connected with the Spring City Foundry Company as President. I have been connected with the foundry

business since the Fall of 1917. I was engaged in the foundry business in 1920 and I have been ever since I started in 1917, except for a brief period in the army.

116 In 1919 I was in Decatur, Illinois, with the Wakeman Casting Company as office manager and sort of assistant general manager, and the president of our company, Mr. Wakeman, I know about his salary. His salary was $20,000 a year.

During the course of my experience in the foundry industry, I have had occasion to make reference to "The Iron Age" quite regularly. I know what standing that publication has, with respect to quotations on iron. We make some of our sale contracts subject to revision in price fluctuations as they appear in the "Iron Age". It has been my observation that pig iron doesn't fluctuate as widely as other commodities. We usually contract for pig iron for three to six months, depending somewhat on market conditions. A fluctuation of $1.00 a ton is a pretty big change in price.

With reference to the company that I have described in Decatur, the sales for 1919 were in the neighborhood of $700,000. The sales for the Spring City Foundry were about $578,000.

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117 On April 17, 1930, there was heard before the Honorable Annabel Matthews, Member of said Board, at Chicago, Illinois, the matter of a motion of the Respondent under Rule 62 of the Rules of Practice of said Board, that the hearing on the issue of special assessment be limited in the first instance to the issues defined in Subdivisions (a) and (b) of said rule. Such motion had been granted by the Board under date of April 7, 1930, without notice to the Petitioner, and the Member was asked to rule whether the Petitioner should, at the hearing then to be had, present any evidence upon the question of special assessment. Rule 62 (in part) is as follows:

"Rule 62. Special assessment.

(a) If some of the issues raised by the petition involve section 327 or section 328 of the Revenue Act of 1918 or of 1921 (or section 210 of the Revenue Act of 1917, as the case may be), and some do not involve such sections, the hearing may, in the discretion of the Board, on motion, be limited in the first instance to trial of the issues which do not involve such sections.

(b) A hearing may, in the discretion of the Board, on motion, be had, limited to the trial of the issue whether the petitioner is entitled to have its tax determined as provided in section 328 (or section 210, as the case may be)."

The Member held that the Petitioner would be obliged to present its evidence in support of its contention that abnormal conditions affected its capital and income in the year 1920, leaving for a subsequent hearing the presentation of evidence as to the proper assessment under Sections 327 and 328 of the Revenue Act of 1918, should it be found that
118 abnormal conditions did affect the Petitioner's capital and income in the year 1920.

The foregoing was all of the testimony offered on behalf of the petitioner upon the issues in this cause as limited by the Member.

No testimony was submitted on behalf of Respondent.

Thereupon the case was submitted to the Member.

The petitioner, Spring City Foundry Co., tenders and presents the foregoing as a statement of the evidence in this case and prays that the same be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

EDGAR L. WOOD,
RICHARD H. TYRRELL,
Attorneys for Petitioner.

119 PETITIONER'S EXHIBITS.

Number

1. Certified copy of Order dated December 24, 1920, issued by U. S. District Court for the Northern District of Illinois, appointing Central Trust Co. of Illinois as Receiver of Cotta Transmission Co.
2. Letter—Cotta Co. to Taxpayer, dated October 11, 1920.
3. Financial statement of Cotta Co.
4. Letter of Cotta Co. to Creditors, dated October 8, 1920.
5. Copy of Resolution of Cotta Creditors, dated October 6, 1920.
6. Audit Report by Arthur Young & Co.

8, 9, 10. Photostat copies of Ledger Sheets of Waukesha National Bank of its account with Taxpayer.

13,14. Copies of Ledger Sheets of Taxpayer's account with Cotta Transmission Co.
21. Copies of original Promissory Notes—Cotta Transmission Co. to Taxpayer.
22. Taxpayer's Promissory Note Record.
23. Summary of Taxpayer's Open Account with Cotta Transmission Co.
24. Summary of indebtedness of Cotta Transmission Co. to Taxpayer.
26. Copy of Taxpayer's Notes Receivable Ledger Record.
27. Taxpayer's Ledger Account of Bills Payable.
28. Copy of Taxpayer's Journal page 94, and one entry from page 90.
30. Copy of Taxpayer's Profit and Loss Statement.
31. Audit Report by Marwick, Mitchell & Co. of Taxpayer's affairs for year ending December 31, 1920.
32. Same as 31 for three years ending December 31, 1919.
120 35. Certified copy of Petition in Involuntary Bankruptcy of Cotta Transmission Co. vertified December 20, 1920, and certified copy of Order of Adjudication in Bankruptcy dated January 20, 1921.
37. Summary of Bankruptcy Schedules of Cotta Transmission Co.
38. Statement of Salaries and Stockholdings of the Officers of Taxpayer.
40. Taxpayer's computation of its ratio of Current Working Assets to Current Debts.
41. Copy of Revenue Agent's Supplemental Report dated November 20, 1925.
42. Summary of Records of Waukesha National Bank showing transactions with Taxpayer.

JOINT EXHIBITS.

B-33. Taxpayer's Return for 1920.
C-34. Taxpayer's Amended Return for 1920.

RESPONDENT'S EXHIBITS.

A. Taxpayer's Protest before Income Tax Unit.

121 Service of a copy of the foregoing agreed statement of evidence is acknowledged this 8th day of February, 1933, and it is agreed that said statement as made may be ap-

proved by the Board Member hearing the case without further notice to any party hereto, and that when so approved may be filed in the Clerk's office and become a part of the record for the purpose of the petition for review in said cause filed by Spring City Foundry Co., Petitioner.

Dated: Feb. 8, 1933.

C. M. CHAREST,
C. M. Charest,
General Counsel for Commissioner of Internal Revenue.

The foregoing statement contains the evidence adduced at the hearing of this cause before the Board of Tax Appeals pertinent to the issues on appeal in the United States Circuit Court of Appeals for the Seventh Circuit, and in order that same may be preserved and made a part of the record on appeal this statement of evidence is duly approved on this 9th day of February, 1933.

(s) ANNABEL MATTHEWS,
Member United States Board of Tax Appeals.

122 PETITIONER'S EXHIBIT 1.

IN THE DISTRICT COURT OF THE UNITED STATES,

For the Northern District of Illinois,

Western Division.

Friday, December 24th A. D. 1920.

Present, the Honorable George A. Carpenter, Judge.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169. Admitted in Evidence Apr. 24, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Marked for Identification Apr. 24, 1930.

In Re
Cotta Transmission Co.
Bankrupt. } No. 609.

On reading and considering the petition of Spring Car Foundry Co. et al. for the appointment of a receiver, the Court being fully advised in the premises, finds that it is absolutely necessary for the preservation of the estate of the

bankrupt that a receiver be appointed to take charge of and conserve the property of the same, and it is therefore ordered that Central Trust Company of Illinois be and hereby is appointed receiver of all the property, equitable interests, things in action and effects of said bankrupt and that it be vested with all the usual rights and powers of receivers in bankruptcy upon filing a bond herein in the penal sum of Ten Thousand ($10,000.00) dollars.

123 United States of America } ss.
Northern District of Illinois }

I, Charles M. Bates, Clerk of the United States District Court in and for the Northern District of Illinois, do hereby certify that the annexed and foregoing is a true and full copy of the original order entered December 24, A. D. 1920 In re: Cotta Transmission Co., Bankruptcy No. 609 now remaining among the record of the said Court in my office.

In Testimony Whereof, I have hereto subscribed my name and affixed the seal of the aforesaid Court at Chicago this 18th day of April, A. D. 1930.

CHARLES M. BATES,
Clerk.

(Seal)

124 United States District Court

..... District of .....

Certified Copy

125 PETITIONER' EXHIBIT 2.

(Cut)

COTTA TRANSMISSION COMPANY

Manufacturers of

Cotta Tranmissions

Positive or Dental Clutch System

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Admitted in Evidence Apr. 24, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Marked for Identification Apr. 24, 1930.

Rockford, Ill. October 11, 1920.

Spring City Foundry Co.,
Waukesha, Wis.

Attention of Credit Department.

Dear Sirs:—

As requested at Chicago, we are enclosing Financial Statement. If there is any further information you desire regarding the affairs of the company, kindly advise us.

Yours very truly,

COTTA TRANSMISSION COMPANY;
A. D. SEVILLE,
Sec'y.

ADS:HP

126 PETITIONER'S EXHIBIT 4.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Admitted in Evidence April. 24, 1930.

Rockford Ill., October 8, 1920.

Dear Sir:

Enclosed please find copies of the resolution proposed and passed at a meeting of Western creditors at Chicago, October 5, 1920, and approved as amended at a meeting of our Eastern creditors held at Buffalo, October 6, 1920, and at a meeting of Rockford creditors held October 8, 1920.

Accordingly, a committee appointed by the five largest creditors consisting of the John Obenberger Forge Co., New Departure Mfg. Co., La Salle Steel Co., Spring City Foundry Co. and the Wena Aluminum Foundry Co., will meet at our plant at once to complete the plans proposed for adjusting the affairs of the Cotta Transmission Co.

Please sign one copy of this resolution as amended and forward by return mail.

Thanking you sincerely for your co-operation, we remain

Very truly yours,

COTTA TRANSMISSION CO.
E. P. REBER, *Vice Pres.*

127 PETITIONER'S EXHIBIT 5.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Admitted in Evidence Apr. 24, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Marked for Identification Apr. 24, 1930.

Resolution Adopted At Chicago Meeting of Creditors of the Cotta Transmission Co., October 6, 1920.

"A committee of the five largest merchandise creditors, or to be appointed by them, shall be created as an executive committee to have charge of the business of the Cotta Transmission Co. cooperating with the present management, until December 15, 1920; that during that period a moritorium be declared, and said committee, meantime, shall device and present to the creditors, a plan of re-organization and continuation of the business of said compairy, and submit the same forthwith to the creditors of the company".

The amendment made by the meeting at Buffalo was and is—that the date fixed in the above quoted resolution should be November 15, 1920 instead of December 15, 1920, is possible.

Approved.....

128 PETITIONER'S EXHIBIT 23.

Exhibit "A"

Statement

Waukesha, Wis., January 25th, 1921.

Cotta Transmission Company
Rockford, Illinois

To Spring City Foundry Co., Dr.

Gray Iron and Semi-Steel

Motor Castings

Kindly Check With Your Ledger and Report Any Difference Promptly

1920					
Aug.	9	Merchandise	Inv. 9885	$ 48.25	
	9	"	" 9886	1280.26	
	12	"	" 9896	48.80	
	13	"	" 9899	143.65	
	24	"	" 9920	1637.13	
	26	"	" 9925	88.77	
	31	"	" 9935	1326.49	
Sept.	16	"	" 9953	1584.00	
	23	"	" 9959	17.16	
	30	"	" 9966	112.09	
	30	"	" 9971	228.14	
	30	"	" 9973	1318.79	$7833.53
		Credits			
Sept.	13	Castings Returned		26.40	
	23	"	"	9.68	
Oct.	4	"	"	26.40	
		"	"	2057	
Nov.	9	Cr. on Cstgs. shipped to Laing Motor Truck Co.		46.54	
	10	Castings Returned		10.67	140.26
					$7693.27

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Admitted in Evidence Apr. 25, 1930.

129 PETITIONER'S EXHIBIT 24.

Summary of Items Due from

Cotta Trammission Company

1920					
July	13	Note due	10/13	$9300.00	
Aug.	16	" "	12/16	6990.00	
	18	" "	12/18	5300.00	Renewal of note due Aug. 18th
	19	" "	12/19	5600.00	Renewal of note due Aug. 19th
Sept.	18	" "	12/17	5100.00	Renewal of note due Sept. 18th
				32290.00	
		Open account—		7693.27	
		Claim (total)		$ 39983.27	

* The note due August 19th was a renewal of a ninety day note for same amount dated July 20, 1920, which in turn was the renewal of a note dated April 19, 1920.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket 21169, Admitted in Evidence Apr. 25, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. 13 Docket Marked for Iidentification Apr. 25, 1930.

130 PETITIONER'S EXHIBIT 35.

Form No. 3.

Creditors' Petition.

To the Honorable George A. Carpenter, Judge of the District Court of the United States for the Northern District of Illinois:

The Petition of Spring City Foundry Co., La Salle Steele Co., and the Werra Aluminum Foundry Company, respectfully shows:

That Cotta Transmission Co., of Rockford, Illinois, has for the greater portion of six months next preceding the date of filing this petition,* had its principal place of business at

Rockford, Ill., in the County of Winnebago, and State and District aforesaid, and owes debts to the amount of $1,000. That the said Cotta Transmission Co. is a commercial corporation organized under the laws of the State of Illinois.

That Your Petitioners are creditors of said Cotta Transmission Co. having provable claims amounting in the aggregate, in excess of securities held by them to the sum of $500. That the nature and amount of your petitioners' claims are as follows:

Spring City Foundry Co.,	Merchandise,	$41,197.13
LaSalle Steel Co.,	Merchandise,	40,269.02
Werra Aluminum Foundry Co.,	Merchandise,	33,516.38

And Your Petitioners Further Represent that said Cotta Transmission Co. is insolvent, and that within four months next preceding the date of this petition the said Cotta Transmission Co. committed an act of bankruptcy, in that he did heretofore, to wit, on the 24th day of August, A. D. 1920, while the said Cotta Transmission Co. was insolvent did pay to McJunkin Advertising Co. the sum of $33528.00 with intent to prefer said McJunkin Advertising Co. as a creditor; and also on the 28th day of August A. D. 1920, while the said Cotta Transmission Co. was insolvent did pay to E P. Reber the sum of $23297.13 with intent to prefer said E. P. Reber as a creditor.

Wherefore Your Petitioners Pray that service of this petition, with a subpoena, may be made upon Cotta Transmission Co. as provided in the acts of Congress relating to bankruptcy, and that it may be adjudged by the Court to be a bankrupt within the purview of said acts.

SPRING CITY FOUNDRY CO.
By H. E. BLAIR, *Prest.*
LASALLE STEEL CO.
By D. E. LADENSOHN, *Secy.*
WERRA ALUMINUM FOUNDRY CO.
By LEO SPITZ, *Secy.*
Petitioners.

LEO SPITZ
ROSS C. HALL
Attorneys.

United States of America, }
Northern District of Illinois } ss.

H. E. Blair, Pres't, Spring City Foundry Co., D. E. Ladensohn, Secy., LaSalle Steele Co. and Leo Spitz, Secry., Werra Aluminum Foundry Company being three of the petitioners above named, do hereby make solemn oath that the statements contained in the foregoing petition subscribed by them are true.

Before me, a Notary Public, this 20th day of December, 1920.

GEORGE M. MESSER,
(Seal) *Notary Public.*
(Official Character)

[Schedules to be annexed corresponding with schedules under Form No. 1.]

*Insert here the words "had his principal place of business" or "resided" or "had his domicile."

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Admitted in Evidence Apr. 25, 1930.

131 Endorsed: Docket No. ..... No. 609. United States District Court, Northern District of Illinois. In Bankruptcy. In the Matter of Cotta Transmission Co. of Rockford, County of Winnebago, State of Illinois. Creditors' Petition. Filed at 11:45 o'clock P. M., this 23rd day of December, A. D. 1920 John H. R. Jamar, Clerk, By M. Douglas Grant, Deputy Clerk. Hall & Spitz, Attorney for Petitioners.

132 IN THE DISTRICT COURT OF THE UNITED STATES,

For the Northern District of Illinois,

Western Division.

In the matter of
Cotta Transmission Company, } In Bankruptcy.
Bankrupt.

At Rockford, in said District, on the twentieth day of January, 1921, before Arthur E. Fisher, one of the Referees in Bankruptcy in and for said District, this cause coming on to be heard at Rockford, at the office of said Referee, upon the petition of Spring City Foundry Company, LaSalle Steele

Company and Werra Aluminum Foundry Company, petitioning creditors, petitioning that the Cotta Transmission Company be adjudged a bankrupt within the true intent and meaning of the Acts of Congress relating to bankruptcy; and it appearing that said petition was filed in the office of the Clerk of said Court on December 23rd, 1920, and that subpoena was thereupon duly issued, and that said subpoena, together with a copy of said petition, was duly served upon said alleged bankrupt on the 28th day of December, 1920, and that said bankrupt has not appeared, answered, pleaded or demurred to said petition, but therein has made default; and it further appearing by the certificate of the Clerk of said Court that there is no Judge present in this District:

Now therefore, it is ordered that said Cotta Transmission Company be, and it hereby is, declared and adjudged a bankrupt within the true intent and meaning of the Acts of Congress relating to Bankruptcy.

Witness Arthur E. Fisher, one of the Referees in and for said District at Rockford, in said District, on the 20th day of January, A. D. 1921.

ARTHUR E. FISHER,
Referee.

133 United States of America
Northern District of Illinois } ss.

I, Charles M. Bates, Clerk of the United States District Court in and for the Northern District of Illinois, do hereby certify that the annexed and foregoing is a true and full copy of the original Creditors' Petition filed December 23rd, A. D. 1920, and Order of Adjudication entered January 20, A. D. 1921, In re: Transmission Company, Bankruptcy No. 609 now remaining among the records of the said Court in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at Chicago, this 15th day of April, A. D. 1930.

CHARLES M. BATES,
(Seal) *Clerk.*

134 United States District Court
..... District of .....
Certified Copy

135 PETITIONER'S EXHIBIT 37.

Summary of Debts and Assets.

(From the Statements of the Bankrupt in Schedules A and B)

Schedule A	1 (1)	Taxes and debts due United States	18.38	
"	" 1 (2)	Taxes due states, counties, districts, etc.	2,423.77	
"	" 1 (3)	Wages	2,173.33	
"	" 1 (4)	Other debts preferred by law	.....	
"	" 2	Secured Claims	177,914.29	
"	" 3	Unsecured Claims	631,748.88	
"	" 4	Notes and bills which ought to be paid by other parties thereto,	.....	
"	" 5	Accommodation paper	.....	
		Schedule A Total		$ 815,278.65
Schedule B	1	Real Estate	104,503.44	
"	" 2-a	Cash on hand	1.34	
"	" 2-b	Bills, promissory notes and securities	39,995.88	
"	" 2-c	Stock in trade	.....	
"	" 2-d	Household goods	.....	
"	" 2-e	Books, prints & pictures	.....	
"	" 2-f	Horses, cows, etc.	.....	
"	" 2-g	Carriages, etc.	.....	
"	" 2-h	Farming stock, etc.	.....	
"	" 2-i	Shipping and shares in vessels	.....	
"	" 2-K	Machinery, tools, etc.	329,011.10	
"	" 2-l	Patents, etc.	6,083.37	
"	" 2-m	Other personal property	495,977.47	
"	" 3-a	Debts due on open accounts	100,290.80	
"	" 3-b	Stocks, negotiable bond, etc.	1,200.00	
"	" 3-c	Policies of Insurance	.....	
"	" 3-d	Unliquidated claims	.....	
"	" 3-e	Deposits of money in bank	1,364.15	
"	" 4	Property in reversion, etc.	.....	
"	" 5	Property claimed to be exempt	.....	
"	" 6	Books, deeds, papers	.....	
		Schedule B Total		1,078,427.55

C. T. Co.
E. P. REBER,
V. P.

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Marked for Identification April 25, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Admitted in Evidence April 25, 1930.

136

Stockholders and Officers	Officers' Salaries	Share-holdings
H. E. Blair—President and Treasurer	$ 6,000.00	400
Allie C. Blair—(Wife of H. E. Blair)	.....	30
Casper Reichl—Secretary and Manager	6,000.00	180
Total	12,000.00	610
Sundry Stockholders	.....	390
	$12,000.00	1,000

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Marked for Identification Apr. 25, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Admitted in Evidence April 25, 1930.

137

PETITIONER'S EXHIBIT 40.

	December 31, 1919	1920
Current and Working Assets:		
Cash on Hand and in Bank	$ 2,776.07	969.85
Accounts Receivable—Trade (Exclusive of Cotta Transmission Company account)	99,174.24*	64,681.65*
Cotta Transmission Company Account—ultimate cash value	.....	11,267.51
Customers' Notes Receivable—Discounted	48,859.00	40,092.97
Accrued Interest Receivable	.....	50.00
Inventories	27,315.19	43,833.98
Total Assets	178,124.50	160,895.96

Current Liabilities:		
Liability to Banks on Advances:		
Single Name Paper	19,000.00	44,300.00
Discounted Paper	48,859.00	40,092.97
Notes Payable—Stockholders	5,000.00	.....
Accounts Payable—Trade	16,712.02	21,577.77
Provision for State and Federal Taxes	44,275.37	38,340.66**
Interest Accrued	108.67	133.19
Dividend Payable (Paid January 20, 1920)	15,000.00	.....
Total	148,955.06	144,444.59
Working Capital	29,169.44	16,451.87
Ratio of Current and Working Assets to Current Debt	1.19	1.11

* Does not include $1,000.00 investment included in accounts receivable in Revenue Agent's report.

** Includes item of $24,312.49 for 1920 Federal income and profit tax whereas amount now proposed is $46,073.11.

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Marked for Identification Apr. 25, 1930.

(Stamp) U. S. Board of Tax Appeals, Div. ..... Docket ....., Admitted in Evidence Apr. 25, 1930.

* * * (Caption) * * *

Promulgated March 10, 1932.

Richard H. Tyrrell, Esq., for the petitioner.

L. A. Luce, Esq., for the respondent.

This proceeding arises upon a determination by the respondent of a deficiency of $19,848.08 in petitioner's income and profits taxes for the calendar year 1920. The petitioner assigns two errors: (1) respondent's refusal to allow the deduction of a certain debt amounting to $39,983.27, which petitioner alleges it ascertained to be worthless and charged off in the taxable year under section 234(a) of the Revenue Act of 1918; and (2) the denial of petitioner's application

to have its excess-profits taxes for that year assessed under sections 327 and 328 on the ground of abnormality.

Findings of Fact.

The petitioner, a corporation with its principal office at Waukesha, Wisconsin, was engaged in the manufacture of gray iron automobile castings. It sold castings to the Cotta Transmission Company, a manufacturer of automobile truck transmissions, of Rockford, Illinois, during the period from March, 1920, to September, 1920, inclusive, for which the latter company agreed to pay $40,302.07. Of this amount, $318.80 was paid or canceled by cash remittances or credit memoranda, leaving a balance of $39,983.27. The petitioner was accustomed to accept from the debtor, the Cotta Company, its promissory notes and to discount them at the bank. Five notes were given by the Cotta Company to the petitioner in 1920 as follows:

1. Dated April 3, 1920, 90 days, 6 per cent, $5,600.
2. Dated May 18, 1920, 90 days, $5,300.
3. Dated June 19, 1920, 90 days, 7 per cent, $5,100.
4. Dated July, 1920, 90 days, $9,300; discounted. When this note came due on October 13, 1920, and was not paid by the debtor, the petitioner gave its own note as maker on November 23, 1920, for 6 months, due May 21, 1921.
5. Dated August 16, 1920, 4 months, $6,990; discounted by petitioner with bank and paid by petitioner on December 21, 1920.

Three of these notes, for $5,600, $5,300, and $5,100, which had been renewed by the debtor from time to time, and had been discounted by petitioner with the bank, when falling due in December, 1920, were taken up by the petitioner,
18 which gave the bank a new note for $16,000 for 6 months, dated December 28, 1920. This note and the note for $9,300 given by the petitioner to the bank were ultimately paid by the petitioner. The total sum of the principal of the notes unpaid by the debtor and paid to the bank in cash by petitioner or by its note in 1920 was $32,390. The notes were unsecured.

The balance due on the petitioner's open account with the debtor at the close of December, 1920, was $7,693.27. This amount was unsecured. Neither the notes claim nor the open account was protected by insurance.

The amount of the Cotta Company's indebtedness to the petitioner, on notes and open account, $39,983.27, was charged

on the petitioner's books on December 28, 1920, to "Profit and Loss," in compliance with the directions of the petitioner's president, Blair, to charge off the debt as bad, after Blair had conferred with the secretary and manager of petitioner, Reichl, on the matter and after examination of debtor's plant and assets, as will be more fully shown later.

The Cotta Company, finding itself in financial straits in the latter part of 1920, requested of its principal creditors at a meeting on October 6, 1920, at Chicago, a five-year extension on all its accounts. This was refused. The creditors then appointed a creditors' committee to investigate the debtor's condition. The Eastern creditors met in Buffalo on the same day and the Rockford creditors met in Rockford on October 8. The petitioner was on the creditors' committee, which was to take charge of the debtor's business until December 15, 1920, a moratorium being declared in the interval. Shortly after the creditors' meeting of October 6, 1920, Blair, president and treasurer of petitioner, together with Reichl, its secretary and manager, went to Rockford to look into the debtor's condition. With them were representatives of other creditors. They looked over the debtor's plant, conferred with various persons, and decided to have an audit of the debtor's affairs made. The committee employed Arthur Young & Company, C. P. A.'s, to examine the debtor's condition and report. The report was made on October 25 as of October 15, 1920.

The Young audit showed the debtor's cash and cash investments at $1,639.73; its accounts receivable at $126,107.92, of which accounts in the amount of $63,108.02 were hypothecated to secure bank loans and overdrafts; inventories at $509,680.36, $446,849 thereof being finished or partly finished transmission parts; promotion and development expense, patent rights, etc., at $195,724.90; plant assets at $425,714.91; additional real estate at $14,947.16; the last three items constituting total fixed assets at $636,386.97; and total assets at $1,275,397.18. On the liability side the audit showed due to creditors, on open account, acceptances and notes, $593,513.81; due to banks on unsecured notes, $122,000, and on secured loans, $32,208.06; and due to officers and miscellaneous, $64,681.70 and $4,617.20, respectively, making total current liabilities, $817,020.77. There was a mortgage on land adjoining factory of $1,200.

The following comment was made on the balance sheet of the audit under the heading "inventories":

From its cost records the Company had arrived at an estimate of inventory at August 31, 1920, but no later figure was available, owing to the abandonment of cost keeping after that date. The manner of handling the cost records makes it impossible at the present time to arrive at an accurate statement of inventory values without a physical inventory. In order, however, to present a complete statement for Balance Sheet purposes we made an estimate based on results of operations for the first eight months of 1920, taking into consideration actual purchases of material, productive labor and overhead expense, the physical inventory valuation of January 1 and the book inventory of August 31. These figures indicated a cost of sales for the eight months of approximately 108 per cent; assuming a similar cost for the remaining 45 days to October 15, we arrived at an amount of $507,080.36 as the probable value of finished goods, work in process, raw materials and scrap at the latter date. A physical inventory of the bar steel and scrap iron on hand (priced and extended by the company staff) indicated their value to be $54,456.14 and $5,775, respectively, the balance of $446,849.22 being set up as finished parts and work in process.

Promotion and Development Expenses, Etc. (Schedules II and III):

The items of engineering and advertising expenses prepaid are stated as they appear on the Company's books. Details of the manner in which these amounts were arrived at by the Company officials are shown in Schedules II and III. The valuation of patent rights is also the one shown by the books. We verified the amount of insurance premiums unexpired. The total value of fire insurance policies in effect at October 15, 1920 is $750,000, with additional amounts of $200,000 covering sprinkler leakage, use and occupancy, etc.

Plant Assets and Non-operating Property (Schedule IV):

These items are stated at the values appearing in the books. We understand that these represent cost prices but have made no verification of this.

The audit took cost prices, but made no attempt to verify them, relying entirely on book values. No allowance was made for obsolete parts. On the whole it was a hasty examination, designed to show fully the liabilities and obligations

of the company, but to report the assets at their face or going-concern value, which was easily ascertainable and might be qualified as the individual creditors should see fit. The ordinary accounting method as to inventory, to take cost or market value, whichever is lower; and as to fixed assets, cost less depreciation, was not applied in the Young audit because of the assumption made as to a constant relation of value to sale price regardless of possible decrease in value or obsolescence.

On November 4, 1920, certain Rockford citizens made offer to the creditors' committee to purchase the debtors' plant and other assets at an amount equal to 33⅓ per cent of the creditors' claims, provided all the creditors should accept. On the creditors' declination of the offer, it was raised to 40 per cent, payable on or before December 15, 1920. Practically all the important creditors accepted, but the offerors found themselves unable to make the offer good by the agreed date, or within the week's extension allowed thereafter.

Three creditors, including the petitioner, then filed with the United States District Court for the Northern District of Illinois a petition in bankruptcy against the debtor, on December 23, 1920. On the following day the Central Trust Company of Illinois was appointed by the court receiver of the debtor in bankruptcy. On the 26th of December, Hummel, the manager of the receivership department of the receiver, went to Rockford and took possession of the bankrupt's property. He made his preliminary investigation in the first week of the receivership, but continued to work on the debtor's affairs for over a year. He discussed its affairs with its creditors.

The schedule of the debtor's assets and debts filed with the court showed debts in the total amount of $815,278.65 and assets of $1,078,427.55. Listed under assets were bills, promissory notes and securties in the amount of $39,995.88, and debts due on open accounts totaling $100,290.80. These two amounts represent quick assets.

The debtor's inventories, as revealed by the receiver's investigation, consisted of parts for the manufacture of transmissions, castings, and some steel, and, although set up on debtor's books at $446,849 (as shown also in the Young audit made for the creditors' committee), had little more than scrap value except for the specific purpose for which they were made. Efforts made before the receivership to sell them

to the suppliers of materials were unsuccessful, and subsequent efforts by the receiver to sell by advertisement also met with no success. The particular type of transmission made by the debtor was not perfect, and the company was constantly having to repair and make good the articles sold.

Of the debtor's accounts receivable, as shown in the balance sheet of the Young audit, about half were pledged to banks. A large part of the remaining half was owed the debtor by firms which were also bankrupt; and on this account in December, 1920, the total unassigned accounts receivable of the debtor were then worth only about $2,000.

On January 20, 1921, the debtor was adjudged a bankrupt, and the Central Trust Company became the trustee in bankruptcy.

No attempt was made by the receiver to sell the plant by advertising immediately after the adjudication in bankruptcy, owing to the market conditions, but a sale was
21 advertised for March 8, 1921. No bids were received.

Nothing further was done until September, 1921, when it was again advertised for sale. It was not sold, however, until some time in 1922, when it went to one Swartz, representing a Rockford syndicate, with all other assets except cash and accounts receivable, for about $175,000.

An attempt was made to collect the accounts receivable immediately after the receiver's appointment and was continued throughout the trusteeship.

The receiver operated the debtor's plant until November, 1921, filling repair orders for customers, in order to collect upon the accounts receivable. The plant during this period was never closed more than 2 weeks at a time. Only about 20 per cent of the old employees, exclusive of the salesmen, who were all dismissed, were retained for the first 6 months, when the employed personnel was increased somewhat. The plant was kept open by the receiver in order to obtain a better price for it and, by filling repair orders, to collect ultimately on old accounts receivable.

The motor-truck market in the fall of 1920 was very much depressed, owing to various causes, but in part to the release at low prices of Government trucks made during the war. At this time the country was suffering from a general depression and its results were evident in Rockford. The debtor's plant was situated on the outskirts of Rockford. A number of other plants in Rockford, including a large pump plant, had been closed down before the debtor's receivership began, and

the largest industry in the town was then operating on a very small scale.

In the spring of 1922 the receiver paid to creditors, including the petitioner, a dividend of 15 per cent of their claims. The petitioner received this payment on March 24, 1922, in the amount of $6,145.91. A second and final dividend of 12½ per cent was paid in 1923, the petitioner's share, received on January 9, 1923, amounting to $5,121.60. These two dividends resulted from the sale of the debtor's plant and assets and the amount collected on its accounts receivable.

The debt owed by the Cotta Company to petitioner became partially worthless in 1920 and was ascertained to be so by the petitioner in that year.

The petitioner kept its books during the year 1920 and filed its income-tax returns for that year on the accrual basis.

The petitioner claimed the full amount of the debt charged off on its books on December 28, 1920, as a deduction in its income-tax return for 1920 and included as income in its returns for 1922 and 1923 the dividends received in the respective years from the trustee in bankruptcy. The respondent disallowed the full amount claimed as a deduction in 1920, but allowed petitioner a deduction from gross income in 1923 of $28,715.76, the difference between the full amount of the Cotta debt and the two dividends received by the petitioner.

For the year in controversy, 1920, the statutory net income of the petitioner as determined by the respondent is $119,017.36, and its statutory invested capital, $157,438.13. For the same year petitioner's profits tax is computed at $38,190.41 and its combined income and profits taxes at $46,073.11.

The average amount, based on monthly balances, which petitioner had borrowed on its own notes from stockholders and various banks and the amount which petitioner had obtained by discounting, under its own endorsement, of debtor's papers, were as follows: Own promissory notes to stockholders, $2,500; to banks, $21,661.54; by endorsement and discount, $89,934.23; grand total average a month, $114,095.77. The notes discounted included those of the Cotta Company. None of the notes was endorsed by petitioner "without recourse." The expedient of discounting its debtor's paper was resorted to by petitioner in order to obtain the necessary cash to carry on its business.

Blair, president and treasurer of petitioner, received as salary in 1920, $6,000, and then owned 400 shares of peti-

tioner's stock; Reichl, as secretary and manager, received $6,000, and owned 180 shares. Blair's wife held 30 shares and other shareholders 390. Blair had charge of credits and collections. Reichl's duties had to do with purchase of supplies and sales. He was also superintendent of the foundry and practical foundryman, in the absence of any general foreman.

The petitioner was never a party to a cost-plus contract with the Government.

OPINION.

MATTHEWS: 1. The first issue before us is whether the petitioner is entitled to any deduction for the year 1920 on account of the debt owed by the Cotta Transmission Company on its notes and open account in the total amount of $39,983.27. The respondent has allowed $28,715.76, the amount of the debt less the amount received by the petitioner as dividends from the debtor's trustee in bankruptcy, as a deduction in 1923.

The debt was charged off in its entirety on December 28, 1920, by the petitioner in good faith and in the belief that little, if anything, would be paid by the receiver on its claim, and having charged off the entire amount in 1920, it returned as income in 1922 and 1923 the amounts received in those years as trustee's dividends.

23 The evidence in this case convinces us that the debt was not entirely worthless at the time of the charge-off on December 28, 1920. The citizens of Rockford had, on November 4, offered to purchase the plant and assets at 33⅓ per cent of the creditors' claims. This offer was declined and the citizens raised it to 40 per cent, payable on or before December 15, the time for payment being extended a week. They were not able, however, to raise the 40 per cent. The creditors then filed a petition in bankruptcy. The inability of the citizens of Rockford to raise the 40 per cent offer, which was accepted, raises doubt as to whether the same persons could have raised even the 33⅓ per cent offer which was rejected. The fact that the creditors filed a petition in bankruptcy at the expiration of the time, as extended, in which the 40 per cent was to be raised indicates that the creditors shared this doubt. It also indicates that they hoped to realize more through bankruptcy proceedings than the citizens of Rockford could pay. However, assuming that the creditors' claims were worth 33⅓ per cent of their face value

at the time of the first offer, the effect of the taking over of the property of the debtor by the receiver was to reduce the amount which the creditors would ultimately receive, at least to the extent of the receivership costs. The amount ultimately received—27½ per cent—is strongly confirmatory of this conclusion. Therefore, taking all facts into consideration as they existed at the time of the charge-off of the entire indebtedness, we think that a reasonable estimate of the cost of the receivership would have been at the least an amount equal to the difference between the 33⅓ per cent and the 27½ per cent of the creditors' claims ultimately received. We conclude, therefore, that the debt was worthless to the extent of $28,715.76 at the time of the charge-off on December 28, 1920. As the debt was not wholly worthless when charged off, the question in controversy is whether the petitioner is entitled to any deduction within the taxable year.

Section 234(a) of the Revenue Act of 1918 provides that in computing the net income of a corporation

> * * * there shall be allowed as deductions:
>
> * * * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> (5) Debts ascertained to be worthless and charged off within the taxable year;
>
> * * * * * * *

The petitioner contends that if the whole debt is not deductible as such in 1920, it is still deductible as a loss under the doctrine of *Sherman & Bryan, Inc.*, v. *Commissioner*, 35 Fed. (2d) 713, and *Davidson Grocery Co.* v. *Commissioner*, 37 Fed. (2d) 806; that, while the cases cited allowed a deduction as a loss of that part of the debt which was never collected, they did not so limit the rule; and that petitioner's loss was established by the turning over of the Cotta Company's business to the creditors in October, 1920, or, in any event, by the filing of the petition in bankruptcy and the appointment of the receiver in December, 1920.

As the debt was not wholly worthless in 1920, petitioner did not sustain a loss in that year equal to the total amount of the debt, and the *Sherman & Bryan* decision is not authority for the deduction of the full amount of the debt under such circumstances.

Petitioner further contends that the item of $39,983.27 never was income and should be eliminated from its gross

income for 1920; that what is taxed is real and not supposed income. In support of this contention, petitioner quotes extensively from the opinion in *Corn Exchange Bank* v. *United States*, 37 Fed. (2d) 34, a case in which the question involved was whether interest accrued to December 31, 1918, on loans made by the Corn Exchange Bank to a company which went into receivership on December 31, 1918, and of which the taxpayer was advised on December 31, 1918, was required to be included in the return for 1918 as an item of accrued income. The court held that the item should not be treated as accrued income. Petitioner argues that, regardless of questions of deductibility, the deficiency assessed must be set aside upon the ground that it is levied upon an item which never was income.

The item here in question represents the amount due petitioner for goods purchased by its debtor in 1920, and such amount includes the cost to petitioner of the goods sold as well as the expected profit on the sale. We think the cases are distinguishable on their facts.

Finally, petitioner submits that should the Board decide that the full amount of the debt is not deductible either as a bad debt or as a loss, and that the amount in question should not be excluded from gross income, it is entitled, under the decisions in *Sherman & Bryan, Inc.*, v. *Commissioner*, *supra*, and *Davidson Grocery Co.* v. *Commissioner*, *supra*, to a deduction from 1920 income of at least $28,715.76, the difference between the principal amount of the claim and the dividends received from the trustee in bankruptcy.

The Treasury interpretation of section 234 of the 1918 Revenue Act is that no deduction is allowable under that act for a debt worthless only in part. Article 151, Regulations 45. This Board adopted the same construction in its earlier decisions, and it is urged upon us by the respondent's counsel that the matter is concluded by those decisions, citing *Steele Cotton Mill Co.*, 1 B. T. A. 299; *Murchison National Bank*, 1 B. T. A. 617; *Toccoa Furniture Co.*, 12 B. T. A. 804; *Milwaukee Lumber Co.*, 17 B. T. A. 163; and *Minnehaha National Bank* v. *Commissioner*, 28 Fed. (2d) 763 (C. C. A., 8th Cir.).

25 All of the decisions cited by respondent were prior to the *Sherman & Bryan* decision and on their facts are distinguishable from *Sherman & Bryan*. In *Minnehaha National Bank* v. *Commissioner*, *supra*, notes either made or endorsed by an individual were written down because the bank

officers believed they could not collect the entire amount of the notes. The individual was not in bankruptcy.

In the *Sherman* case the taxpayer, a corporation, was creditor of a motor truck company on an open account. The year involved was the petitioner's fiscal year ending September 20, 1920. In November, 1919, an equity receiver was appointed for the debtor company and the taxpayer filed its claim as a general creditor. No dividend was paid in the taxpayer's fiscal year 1920; and in that year the taxpayer, after investigation, charged off the debt as worthless. The Commissioner disallowed the deduction on the ground that the debt was worthless only in part. A dividend, the amount of which was not shown in evidence, was paid in 1921. The instant case, therefore, appears to be on all fours with the *Sherman* case, so far as all material facts are concerned.

The Circuit Court held that the taxpayer's determination that the debt was wholly worthless in 1920 was not a reasonable conclusion of the taxpayer after an adequate investigation, on this point sustaining this Board's decision in the same case, 9 B. T. A. 213. With respect to the ascertainment of worthlessness, the court said:

* * * * * * *

> * * * While we have no doubt of the bona fides of Mr. Sherman's belief that the debt was worthless, we are not convinced that he had ascertained it to be worthless, within the meaning of the statute. To ascertain is to make sure by investigation, and it is conceded that to justify charging off a debt for tax purposes the taxpayer must make a reasonable investigation of the facts and draw a reasonable inference from the information thus obtainable. * * * While creditors are not required to be "incorrigible optimists", they may not be unduly pessimistic when claiming deductions for worthless debts. We are not satisfied that the petitioning taxpayer's determination that its debt was wholly worthless was a reasonable conclusion after adequate investigation. * * *

The other issue of law considered by the court in the *Sherman* case was the deductibility under the 1918 Act of so much of the debt as was proved worthless. The Government had contended that a debt worthless in part was not deductible under that act and that such construction was supported by the fact that Congress, in the 1921 Act, permitted a deduction for a partial charge-off. The court pointed out that subsequent legislation was not conclusive that the construc-

tion claimed for the earlier act must be accepted, and said that "debts ascertained to be worthless" might reasonably be construed to mean "indebtedness ascertained to be worthless" and to permit a charge-off of such part of a claim as was proven to be uncollectible by so definite an event as seizure of the debtor's property by a receiver. The court held, however, that it was unnecessary to decide this point because "if clause (5) does not permit a deduction, we think it may be made under clause (4)." The Government urged that clauses (4) and (5) were mutually exclusive and that since clause (5) covered losses arising from worthless debts, clause (4) must cover only losses otherwise arising. As to this contention, the court held that since the argument assumes that clause (5) does not permit the charge-off of a debt partially bad, there would seem to be no inconsistency in allowing the partial loss under clause (4), even if the two clauses were deemed mutually exclusive, pointing to the fact that it had not been authoritatively determined that they were mutually exclusive. After quoting from *United States* v. *White Dental Co.*, 274 U. S. 398, to the effect that the statute contemplated the deduction of losses "fixed by identifiable events," and "in the case of debts, by the occurrence of such events as prevent their collection," the court said:

26

> The seizure of the debtor's property by a receiver prevents collection, and definitely fixes the loss to be the difference between the face of the debt and whatever dividend the receivership may pay. The Commissioner's position leads to the conclusion that, if any dividend is likely, no loss can be deducted until the receivership is wound up, which may be many years later. Business men do not carry on their books at face value claims against a debtor in receivership, and it cannot be supposed that the Revenue Act of 1918 was intended to require them to do so. When a creditor's debtor goes into receivership, and the creditor believes the debt to be worthless and charges it off, he recognizes that he has sustained a loss at least to the extent that the receivership dividend which may thereafter be declared leaves the debt unpaid. Presumptively the taxpayer's decision that a debt is worthless, and so charged off, measures his loss. If the Commissioner surcharges his return because of a mistake as to the amount of the loss, we think he should not surcharge for so much of the loss as he admits

has been suffered. No judicial decision has been found which contradicts this view.

The *Sherman* case was followed by the District of Columbia Court of Appeals in the *Davidson* case, that case presenting somewhat similar facts, the principal difference being the partial charge-off made by the taxpayer in the latter.

Although in terms the court allowed the deduction of so much of the debt as was determined to be worthless, as a loss, it made the basis of such allowance the ascertainment of worthlessness and the charging off which the statute requires in the case of bad debts, and made it clear that in its opinion the statute respecting the deduction of debts "ascertained to be worthless" did not prohibit the deduction of so much of the claim as was definitely determined to be worthless and 27 charged off. The effect of the court's decision is to hold that the Revenue Act of 1918 permits a taxpayer to charge off that part of a claim against a debtor in receivership which has been ascertained to be worthless. We agree with this construction and, further, think that the amount thus ascertained to be worthless and charged off in the taxable year is a loss deductible under (5) as a debt ascertained to be worthless and charged off.

A debt which becomes worthless in whole or in part is a loss to the extent of the worthlessness. Such a loss is deductible in the taxable year in which the debt is ascertained to be worthless and charged off. There is no provision in the statute under which such a loss may be deducted in any other year than the one in which the ascertainment of worthlessness and charge-off occur. The statute makes the allowance of a deduction for worthless debts mandatory: "* * * there shall be allowed as deductions, * * * debts ascertained to be worthless and charged off within the taxable year." To hold that the language used applies only to those debts ascertained to be totally worthless and charged off and not to debts ascertained to be worthless in part and charged off, would result in a discrimination between creditors with wholly worthless debts and those with debts worthless only in part. As was said by the court in the *Sherman* case, business men do not carry on their books at face value claims against a debtor in receivership, when it is definitely known that the claims can not be paid in full, and it can not be supposed that the Revenue Act of 1918 was intended to require them to do so until final liquidation of such claims in order to claim any deduction on account of such loss. The change in the Revenue Act of 1921 which allows the deduc-

tion of that part of a debt ascertained to be worthless and charged off may well indicate the unexpressed intention of the Revenue Act of 1918; that is to say, the new provision may well be regarded as declaratory of the meaning of the same provision of the 1918 Act. In this view of the matter, that part of a debt which the creditor upon a reasonable investigation of all the facts determines to be worthless and charges off is a "debt ascertained to be worthless and charged off" within the meaning of the statute, and is deductible as such.

In the instant case, as in the *Sherman* case, the petitioner was unduly pessimistic in determining that the debt was totally worthless. A reasonable inference from the facts available at the time of the charge-off justifies the inference that the debt was worthless at least to the extent of $28,715.76, and we think that this amount is deductible in the year 1920.

2. With respect to the second issue, we find, after a careful review of the facts and petitioner's arguments predi-
28 cated upon them, no abnormality, and therefore no proper basis for special assessment. The petitioner has not established that any ground for special relief exists by reason of its officers' salaries. The application rests, therefore, principally upon the petitioner's allegation that so large a part of the capital employed in its business was borrowed and its statutory invested capital consequently so low as to be disproportionate to the volume of its sales and statutory net income. It was shown that petitioner had an average borrowed capital, based on monthly balances, in 1920, of $114,095.77, and of this amount $89,934.23 constituted "two-name (discounted) paper." Blair, president and treasurer of the petitioner, testified that the figures under this heading represented promissory notes made payable to the petitioner and given to it by its various debtors, which were discounted after indorsement by the petitioner at the bank.

This Board has held that the discounting of negotiable promissory notes does not constitute borrowing capital and is not a pledge of the notes for the amount so borrowed, but is in effect the sale of the notes to the indorsee. *American National Bank of St. Paul*, 14 B. T. A. 476. The Board stated its conclusion therein:

> From the cases and texts above cited, it seems to be well settled that to discount negotiable paper is to sell it. We have found no provision in the Reserve Banking Act which changes such generally accepted principle as to transactions between Federal Reserve Banks and mem-

ber banks. It follows that petitioner sold its rediscounted paper to the Federal Reserve Bank and that such bank thereby became owner in exactly the same sense that petitioner owns the notes it discounts for its customers. The respondent's determination is approved.

If we deduct, then, the amount of discounted paper, we find that the petitioner's average borrowed capital in 1920 was approximately $24,000, or about 15 per cent of the statutory invested capital of $157,000, certainly not a sufficient amount to create an abnormal condition. In *Higginbotham-Bailey-Logan Co.*, 8 B. T. A. 566, it was shown that 40 per cent of the petitioner's operating capital was borrowed, but the Board said:

> * * * In many businesses this would not be regarded as unusual or abnormal and in the absence of any evidence that it is abnormal in the wholesale dry goods business, there is nothing on which we may base an opinion as to normality or abnormality.

We do not find in the petitioner's situation any abnormality to justify the allowance of special assessment under section 327.

Reviewed by the Board.

Judgment will be entered under Rule 50.

STERNHAGEN dissents.

MURDOCK, dissenting: The prevailing opinion allows the petitioner to deduct in the year 1920 a portion of a debt owed to it by the Cotta Transmission Company. The Board has consistently held in at least twenty-three cases that under the Revenue Act of 1918 no deduction may be taken where a taxpayer ascertains that a debt is recoverable only in part. It has held that under that act there may be no deduction for a bad debt prior to the time that the taxpayer ascertains that the debt is wholly worthless. The regulations of the Commissioner promulgated under revenue acts prior to the Revenue Act of 1921 have provided to the same effect. Decisions of the Board in which it has made such a ruling have been affirmed on appeal in at least three instances. See also *Selden* v. *Heiner*, 12 Fed. (2d) 474. In two instances such decisions of the Board have been reversed. One of the two cases in which the Board has been reversed on this question is *Sherman & Bryan, Inc.*, v. *Blair*, 35 Fed. (2d) 713. There the court did not decide the question whether partial worthlessness could be deducted under the Revenue Act of 1918, but held that in any event the amount could be deducted as a

loss. I believe that the bad debt and loss provisions of the revenue acts are mutually exclusive, even though I concede that in ordinary parlance a bad debt would be considered a loss. Cf. *Lafayette Lumber Co.*, 20 B. T. A. 993. The other reversal was in *Davidson Grocery Co.* v. *Lucas*, 37 Fed. (2d) 806, where the court approved the reasoning in the *Sherman & Bryan* case. With all due respect to these courts, I find myself unable to agree with their reasoning and feel that until some more compelling reason appears, the Board should be consistent and follow its former decisions. *Minnehaha National Bank* v. *Commissioner*, 28 Fed. (2d) 763. Cf. *Collin County National Bank* v. *Commissioner*, 48 Fed. (2d) 207.

VAN FOSSAN, MCMAHON, GOODRICH, and LEECH agree with this dissent.

29 * * (Caption) * *

DECISION.

Pursuant to findings of fact and opinion promulgated March 10, 1932, the respondent herein, to-wit, on April 15, 1932 having filed a proposed redetermination for the year 1920, and the petitioner on May 4, 1932, having filed notice of acquiescence to the said proposed redetermination, it is

Ordered and Decided that there is a deficiency for the year 1920 in the amount of $6,638.83.

(Signed) ANNABEL MATTHEWS,
(Seal) *Member.*

Entered: May 13, 1932.

36 * * (Caption) * *

Filed Nov. 4, 1932.

To: David Burnet, Commissioner of Internal Revenue,
Washington, D. C.

To: C. M. Charest, General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

You are hereby notified that Spring City Foundry Co. did on the 3rd day of November, 1932, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a

petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Board heretofore rendered in the above entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 3rd day of November, 1932.

EDGAR L. WOOD,
RICHARD H. TYRRELL,
Attorneys for Petitioner.

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of November, 1932.

DAVID BURNET,
Commissioner of Internal Revenue.
(s) C. M. CHAREST,
Attorney for Commissioner, Respondent.

30 * * * (Caption) * * *

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

Filed Nov. 4, 1932.

To the Honorable, the Judges of the United States Court of Appeals for the Seventh Circuit:

Now comes Spring City Foundry Co., by Edgar L. Wood and Richard H. Tyrrell, its attorneys, and respectfully shows:

I.

Jurisdiction for Review.

This is a proceeding for review by the United States Circuit Court of Appeals for the Seventh Circuit of a decision of the United States Board of Tax Appeals entered on the 13th day of May, 1932, determining a deficiency in income and profits taxes for the calendar year 1920 against your petitioner in the amount of $6,638.83.

Your petitioner (hereinafter sometimes referred to as the taxpayer) is a corporation duly organized and existing
31 under the laws of the State of Wisconsin, having its principal office and place of business in the City of Waukesha, County of Waukesha, Wisconsin, and filed its Federal Income Tax return for the calendar year 1920 with the Collector of Internal Revenue in the City of Milwaukee, County of Milwaukee, State of Wisconsin. That both of said places are within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit.

The respondent (hereinafter sometimes referred to as the Commissioner) is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

II.

Nature of Controversy.

The Commissioner refused to allow as a deduction in computing taxable net income for the year 1920 an amount of $39,983.27, which the taxpayer claimed as a bad debt owing by the Cotta Transmission Company arising from the sale of castings to that company. The sales were made during the period from March, 1920, to September, 1920, inclusive. The taxpayer from time to time during the period that the sales were made took short term notes from the debtor for all but $7,693.27 of the $39,983.27; all but one of these notes
32 were renewed one or more times at the request of the debtor and all such notes and renewals thereof became due during the year and nothing was paid thereon. All notes and the open account item were at all times unsecured. The debtor was unable to pay its debts and after an investigation by a creditors' committee bankruptcy proceedings were started, all within the year 1920. The taxpayer ascertained in December, 1920, that the debt was worthless and on December 28, 1920, actually charged the account off its books as worthless. In its income tax return for 1920 it claimed said bad debt as a deduction. The Commissioner disallowed the deduction.

On Appeal to the Board of Tax Appeals, the final administrative agency in the Executive branch of the Government,

said Board concluded that the debt was only partially worthless and allowed the taxpayer a deduction of $28,715.76.

The taxpayer also duly applied to the Commissioner for special relief in the assessment of taxes upon its 1920 income pursuant to Sections 327 and 328 of the Revenue Act of 1918. The Commissioner denied this application and in the proceedings before the Board the Board limited its consideration of the matter to the question whether abnormal conditions affected the taxpayer's capital and income for the year 1920, thus entitling the taxpayer to such relief. The Board concluded that there was no abnormality and therefore no proper basis for special assessment.

33

III.

Assignments of Error.

Your petitioner further shows that it is aggrieved by the action of said Board and injured thereby, and that the errors complained of are as follows:

1. Said Board erred in failing to find that the debt of $39,983.27 was entirely worthless within the meaning of the income tax law at the time of the charge off on December 28, 1920, though requested so to find and though such finding was amply warranted by the evidence.

2. Said Board erred in refusing to allow the full bad debt of $39,983.27 as a deduction in computing taxpayer's taxable net income for the year 1920.

3. Said Board erred in failing to find that abnormal conditions affected the capital and income of the taxpayer for the year 1920, which worked upon the taxpayer an exceptional hardship entitling the taxpayer to special relief under the provisions of Section 327 and 328 of the Revenue Act of 1918, though requested so to find and though such finding was amply warranted by the evidence.

4. Said Board erred in failing to find that taxpayer is entitled to special relief in the assessment of taxes upon its 1920 income as provided by Sections 327 and 328 of the Revenue Act of 1918.

5. Said Board erred in failing to find that there is no deficiency for the year 1920.

34 Wherefore, your petitioner prays that this court may review the decision of the United States Board of Tax Appeals in this cause, directing said Board:

1. To allow as a deduction in the computation of taxpayer's net taxable income for the year 1920 the full amount of the bad debt loss of $39,983.27.

2. To determine that abnormal conditions affected the taxpayer's capital and income for the year 1920, entitling it to special relief within the provisions of Sections 327 and 328 of the Revenue Act of 1918, and to require the Commissioner to recompute the taxes of the taxpayer based upon its income for the year 1920 under special assessment pursuant to the provisions of Sections 327 and 328 of the Revenue Act of 1918.

EDGAR L. WOOD,
RICHARD H. TYRRELL,
Attorneys for Petitioner,
404 Security Building,
213 West Wisconsin Avenue,
Milwaukee, Wisconsin.

35 State of Wisconsin }
Milwaukee County } ss.

WM. J. GREDE, being duly sworn, says that he is President of Spring City Foundry Co., a corporation, the petitioner above named, and that he is duly authorized to verify the foregoing petition; that he has read said petition and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

WM. J. GREDE.

Subscribed and sworn to before me this third day of November, 1932.

JOHN C. WARNER,
Notary Public, Milwaukee County, Wisconsin.

(Notarial Seal)

My commission expires Dec. 23, 1933.

red Dec. 1932. 138 * * (Caption) * *

ORDER ENLARGING TIME.

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to February 2, 1933.

(Signed) LOGAN MORRIS,
Member.

(Seal)

Dated: Washington, D. C.,
Dec. 19, 1932.
jd

red Jan. 1933. 139 * * (Caption) * *

ORDER ENLARGING TIME.

On motion of counsel for the petitioner and consent of counsel for the respondent, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to March 4, 1933.

(Signed) LOGAN MORRIS,
Member.

(Seal)

Dated: Washington, D. C.,
Jan. 23, 1933.
jd

140 * * (Caption) * * Entered M. 1933.

ORDER ENLARGING TIME.

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to April 15, 1933.

(Signed) LOGAN MORRIS,
Member.

(Seal)

Dated: Washington, D. C.,
March 4, 1933.
jd

141 * * (Caption) * * Entered A 12, 1933.

ORDER ENLARGING TIME.

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to May 1, 1933.

(Signed) LOGAN MORRIS,
Member.

(Seal)

Dated: Washington, D. C.,
April 12, 1933.
jd

Feb. 8, 3. 142 * * (Caption) * *

PRAECIPE FOR RECORD.

Filed Feb. 8, 1933.

To the Clerk of the United States Board of Tax Appeals:

Please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, on or before March 4, 1933, copies duly certified as correct of the following documents and records in the above entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by Spring City Foundry Co.:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board:
(a) Petition, including annexed copy of deficiency letter.
(b) Answer.
3. Findings of Fact and Opinion of the Board.
4. Decision of the Board.

143 5. Petition for review, together with proof of service of filing petition for review and of service of a copy of petition for review.

6. Statement of evidence lodged Feb. 8, 1933, including all exhibits set forth in the list attached thereto.

7. Order, dated December 19, 1932, enlarging the time to February 2, 1933, for the transmission and delivery of documents.

8. Order, dated January 23, 1933, enlarging the time to March 4, 1933, for the transmission and delivery of documents.

9. This Praecipe.

Said transcript to be prepared and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Seventh Circuit.

EDGAR L. WOOD,
Edgar L. Wood
RICHARD H. TYRRELL,
Richard H. Tyrrell
Attorneys for Petitioner,
213 West Wisconsin Avenue,
Milwaukee, Wisconsin.

Service of a copy of the within Praecipe is hereby admitted this 8 day of February, 1933.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

144 * * (Caption) * *

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 140, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 15th day of April, 1933.

(Seal)

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

Apr. 10, 145 Filed April 10, 1933.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

Spring City Foundry Co., *Petitioner,*
vs.
Commissioner of Internal Revenue, *Respondent.*
} ..... Term, A. D., ... No. .....

It appearing that it is proper and necessary that certain exhibits as set forth on the schedule annexed to the statement of evidence herein and referred to in the said statement of evidence and incorporated therein by reference should be inspected by this court in their original forms;

Now, Therefore, upon reading and filing the annexed stipulation by Counsel and upon motion of Edgar L. Wood and Richard H. Tyrrell, counsel for Spring City Foundry Co.,

It Is Ordered that said exhibits be transmitted by the Clerk of the U. S. Board of Tax Appeals to this court in their original form in connection with the statement of evidence and transcript, and that such exhibits need not be printed as part of the record herein.

Dated this 31st day of March, 1933.

By the Court:

(s) SAMUEL ALSCHULER,
Circuit Judge.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit begun and held in the United States Court Room in the City of Chicago, in said Seventh Circuit on the fourth day of October, 1932, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Two, and of our Independence the One Hundred and Fifty-Seventh.

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

And on the tenth day of May, 1933, the following proceedings were had and entered of record, to-wit:

Wednesday, May 10, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

It appearing that each of the parties to that certain proceeding before the United States Board of Tax Appeals en-

titled Spring City Foundry Co., Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 21169, has appealed to this court and the appeal of the Commissioner of Internal Revenue has been perfected and is now pending herein, and it further appearing that the said United States Board of Tax Appeals has entered an order extending the time to April 15, 1933, for the transmission of the record of the tax payer Spring City Foundry Co.; and it appearing desirable that said appeals be consolidated for hearing and argument;

Now, therefore, upon reading and filing the annexed stipulation by counsel and upon motion of Edgar L. Wood and Richard H. Tyrrell, counsel for Spring City Foundry Co.,

It is ordered that said appeals be consolidated for hearing and arguinent.

It is further ordered that the brief of Spring City Foundry Co. as Respondent in the above entitled Cause No. 4912 may be served and filed at the time of filing and as a part of the brief of Spring City Foundry Co., as Petitioner in the cause on its appeal.

And afterwards, to-wit: On the eleventh day of May, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

The Clerk will enter our appearance as counsel for the petitioner.

Edgar L. Wood, Richard H. Tyrrell, 404 Security Building, Milwaukee, Wisconsin.

Endorsed: Filed May 11, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the twelfth day of May, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

The Clerk will enter my appearance as counsel for the respondent.

Sewall Key, Department of Justice.

Endorsed: Filed May 12, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the twenty-sixth day of June, 1933, there was filed in the Office of the Clerk of this court an appearance of counsel for the respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932.

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

The Clerk will enter our appearances as counsel for the respondent.

E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. Edward A. Tonjes, Special Attorney, Bureau of Internal Revenue.

Endorsed: Filed June 26, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the twenty-fifth day of July, 1933, there was filed in the office of the Clerk of this court a motion for substitution of party petitioner, which said motion for substitution is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

MOTION FOR SUBSTITUTION

Comes now the above named petitioner and moves the court that Guy T. Helvering, Commissioner of Internal Revenue, be substituted for David Burnet as respondent herein, and in support of said motion respectfully shows:

1. That the resignation of said David Burnet, who was Commissioner of Internal Revenue when the petition for review in this proceeding was filed, was duly accepted and he ceased to be such officer on May 15, 1933.

2. That Guy T. Helvering was duly appointed and confirmed as Commissioner of Internal Revenue to succeed the said David Burnet; that he qualified as such officer and entered upon the duties of said office on June 6, 1933, since which date the said Guy T. Helvering has been and now is Commissioner of Internal Revenue.

3. That there is a substantial need for continuing and maintaining this proceeding and obtaining an adjudication of the questions involved, for otherwise the order of the United States Board of Tax Appeals herein sought to be reviewed will become final and the right to have the legality thereof determined will be extinguished.

This motion is made pursuant to the provisions of Section 11 of the Act of February 13, 1925, c. 229, 43 Stat. 941 (U. S. C., Title 28, Sec. 780).

Richard H. Tyrrell, Attorney for Petitioner.

The undersigned, attorney for Guy T. Helvering, Commissioner of Internal Revenue, hereby expressly consents to the substitution sought by the above motion.

Sewall Key, Special Assistant to the Attorney General, Attorney for Guy T. Helvering, Commissioner of Internal Revenue.

Endorsed: Filed July 25, 1933, Frederick G. Campbell, Clerk.

And on the same day, to-wit: On the twenty-fifth day of July, 1933, the following further proceedings were had and entered of record; to-wit:

Tuesday, July 25, 1933

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Upon motion of the petitioner, expressly consented to by Guy T. Helvering, Commissioner of Internal Revenue, it is hereby ordered that said Guy T. Helvering, as such officer, be and he hereby is substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

And afterwards, to-wit: On the twentieth day of September, 1933, there was filed in the office of the Clerk of this Court an appearance of counsel for the respondent,

which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

The Clerk will enter our appearances as counsel for the respondent.

Pat Malloy, Assistant Attorney General. Sewall Key and F. Edward Mitchell, Special Assistants to the Attorney General.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court Room in the City of Chicago, in said Seventh Circuit on the third day of October, 1933, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Three and of our Independence the One Hundred and Fifty-Eighth.

Tuesday October 3, 1933.

Court opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

It is ordered by the court that this cause be, and the same is hereby set down for hearing on October 19, 1933.

And afterwards, to-wit: On the nineteenth day of October, 1933, the following further proceedings were had and entered of record, to-wit:

Thursday, October 19, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Now this day come the parties by their counsel and this cause now comes on to be heard on the printed record and briefs of counsel and on oral arguments by Mr. Richard H. Tyrrell, counsel for petitioner, and by Mr. F. Edward Mitchell, counsel for respondent, and the court having heard the same takes this matter under advisement.

And afterwards, to-wit: On the tenth day of November, 1933, there was filed in the office of the Clerk of this court the opinion of the court, which said opinion is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933, OCTOBER SESSION, 1933

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

No. 4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—November 10, 1933

Before Alschuler, Evans, and Sparks, Circuit Judges

Both the Commissioner and the taxpayer prosecute appeals from the decision of the Board of Tax Appeals. The taxpayer claimed a deduction of $39,983.27 from its income for the year 1920, because one of its accounts became allegedly worthless and was "written off" that year. The Commissioner disallowed the deduction in toto. The Board allowed it to the extent of $28,715.76.

The Commissioner contends that a partially worthless debt may not be deducted under Section 234 (a); while the taxpayer argues that such partial worthlessness may be deducted either as a bad debt or as a loss. On its appeal, the taxpayer also contends that the evidence necessitated the allowance of a deduction of the full amount of the debt, namely, $39,983.27.

EVANS, Circuit Judge.

The taxpayer was a Wisconsin corporation engaged in manufacturing automobile castings. It sold certain of its goods to Cotta Transmission Company of Rockford, Illinois, which company became indebted to it in 1920, in the sum of $39,983.27.

In the fall of 1920 the debtor's financial breathing became labored. It was unable to meet its obligations and frankly wrote to its creditors asking for a five year extension of credit. Pursuant to this request the creditors met and appointed a creditors' committee who in turn selected an auditing company to examine the debtor's books. Pending such report a committee of Rockford citizens, interested in keeping the plant going, offered the creditors thirty-three and one-third cents for each dollar of unsecured claims. The creditors declined the offer. The citizens then offered forty cents on the dollar, and the offer was accepted. The time limit for fulfilment was short, and the citizens' committee failed to raise the money within the specified time, which was extended one week. The debtor was, upon petition of three creditors, thereupon adjudged a bankrupt. A receiver was appointed December 24, 1920, who immediately took possession of the property and conducted the business in a desultory sort of a way until the property was sold early in 1922.

The company's books showed it had conducted a successful business from 1911 to 1919, inclusive. Each year showed a substantial profit, and the volume of business grew from $100,000 to $1,963,000. Each year's business was conducted at a profit, the smallest amount being $2,702 and the largest year's profit being $70,203. In 1911, the capital stock was $39,600; raised in 1917 to $100,000. In 1919, it was increased by the addition of $166,000 preferred stock, and this amount was again increased in 1920. For reasons not appearing, the business turned sour in 1920, and for the first nine and one-half months of that year there was a loss of $84,790.

One asset item entitled to particular consideration was that known as the plant. It was carried on the books of the company at $425,714.91, which figure was accepted by the company making the audit. This item included land, $6,017; factory building, $55,328; building equipment, $23,722; machinery, $126,375; tool equipment, $192,323; and sundry equipment such as furniture, fixtures, hardening plant, etc., $21,946. Some of the goods manufactured was covered by patents which belonged to the debtor. There is no evidence of patent value other than that which might be inferred from the volume and growth of debtor's business.

Early in 1922, the receiver sold the plant for $175,000

and paid dividends to common creditors aggregating 27½ per cent.

The appeals raise two questions, both of which bear on the taxpayer's deduction from 1920 income: (a) Was the account, for which the taxpayer claimed a deduction of the whole amount, worthless? (b) If not worthless, was the taxpayer in 1920 permitted to deduct a sum which measured its depreciation?

Was the account worthless?

We could justifiably answer this question by observing that the evidence was such as to warrant the negative answer which the Commissioner and the Board of Tax Appeals gave to it. And it might be added that there was evidence sufficient to sustain an affirmative answer. In other words, the testimony was conflicting, or at least conflicting inferences were deducible therefrom. Nevertheless, as counsel strongly attacked the Board's finding and as the outcome of its appeal depends on the success of this attack, we will discuss the evidence.

That the account was not good, not worth even fifty cents on the dollar, is established rather clearly. This is shown by the fact that the creditors, after learning of the debtor's embarrassment, appointed a committee which investigated the debtor's business affairs, and, after such investigation, secured an audit, and, on the receipt of a report on the debtor's business, agreed to take forty cents on the dollar for unsecured accounts.

That the account was not entirely worthless seems equally well established by the fact that the creditors refused to accept a cash offer of thirty-three cents on the dollar. This offer occurred in December, 1920, the same month that petitioner charged its account off as worthless. From this evidence alone, the Board was justified in finding that the account was not worthless.

There was, too, the statement of an Audit Company. True, this audit was one of those valueless statements so commonly made where a balance is struck by copying figures furnished by the company and which showed the amount of the debts on the one side and a statement of the assets on the other. The purported value of the assets appearing in the audit had not the remotest relation to current values. This audit was well nigh worthless, but if it had any value at all, it showed the company was solvent,

on which hypothesis the account was worth its face value.

Finally, supporting the Board's finding is the evidence that the receiver sold the manufacturing plant (the major part of the total assets) for $175,000 and paid a dividend after all expenses of administration of 27½ per cent. The plant, which the company carried on its books at $425,000, was unincumbered. The fact that it sold, after bankruptcy intervened, for $175,000 is conclusive proof that the accounts were not worthless, for the proceeds of this item supplied cash sufficient to pay a 27½ per cent dividend.

Against this fact, the taxpayer offered the opinion of its officers and one who was the receiver's representative in the bankruptcy proceeding. Petitioner's officers gave no satisfactory explanation which would reconcile their refusal to accept thirty-three cents on the dollar with their contention that the account was worthless, save as they were advised by the receiver, a few days after he took his office, December 24, 1920, that the account should be charged off entirely. But the testimony of this receiver's agent must be viewed in the light of our observation of, and experience with, men occupying such positions. It is not uncommon for professional receivers, as well as their counsel, to admit, at the sacrifice of modesty, but in the interest of truth, that their services were of immeasurable value to the estate which is being conserved. Notwithstanding the probative value of admissions, we think the receiver here, as often happens, somewhat overestimated his services and the value of his contribution to the estate. He was a receiver located in Chicago, handling many other receiverships. He took charge of this company's affairs and advertised the property for sale twice. Once he had no bids; the second time he was offered $175,000. This was less than the Rockford citizens had offered before bankruptcy proceedings were instituted, and we are therefore unwilling to assume that it was the receiver's salesmanship or uncanny judgment which was the sole cause of a realization of $175,000 for property of no value. From the record before us, we are convinced that it would have been more logical to conclude that the bankruptcy proceedings were of little help in salvaging the estate and that the account of the taxpayer, while impaired, was far from worthless; that the property, most of which was unincumbered, could under any circumstances have been sold for

enough to produce better than thirty cents on the dollar for all unsecured accounts.

We conclude therefore that not only does the evidence sustain the finding of the Board, but that there was little substantial evidence to the contrary.

The foregoing conclusion as to the value of the account makes it necessary for us to consider the second phase of these appeals, viz., the deductibility of a part of a debt which had become impaired in value, but which was not worthless.

The question is one of statutory construction.

The Revenue Act of 1918 provided for the following deductions: "Sec. 234 (a) (4), "Losses sustained during the taxable year and not compensated for by insurance or otherwise * * *." (5) Debts ascertained to be worthless and charged off within the taxable year; * * *."

Respecting these two sections, two Courts of Appeal have reached different conclusions: Sherman & Bryan, Inc. v. Commissioner, 35 F. (2d) 713 (C. C. A. 2); Minnehaha National Bank v. Commissioner, 28 F. (2d) 763 (C. C. A. 8). The Board of Tax Appeals, prior to the entry of the decree here reviewed, has uniformly (twenty-six times) held that to be deductible under the 1918 Act, an account must have become worthless. Other decisions have been called to our attention, which are worthy of consideration. (Davidson Grocery Co. v. Lucas, 37 F. (2d) 806; Murchison Nat. Bank v. Grissom, 50 F. (2d) 1056; Southern Cal. Box. Co. v. U. S., 46 F. (2d) 724; Collin County Nat. Bank v. Commissioner, 48 F. (2d) 207.)

The Act of 1921 amending this section and permitting deductions which represent the amount of the impaired value of the account is, according to the Commissioner, most significant. Elaborate discussion of the language of the act which allowed deductions, the reasons for the Board's ruling, and other matters worthy of consideration in construing this act of Congress, we think, are unnecessary. We will content ourselves with stating our conclusions which are as follows:

Sections (4) and (5) of subsection (a) of section 234, are mutually exclusive. Section (5) alone covers the taxpayer's case. Section (5) provides for deductions only in case the account is worthless. In other words, there was in 1920 no authority for a debt deduction unless the debt were worthless.

The taxpayer also argues that he was entitled to the special consideration provided for by Sections 327 and 328 of the Revenue Act of 1918. While it seems to us that the taxpayer made out a somewhat persuasive argument in support of its appeal to the Commissioner, we are not convinced that the action of the Commissioner was an abuse of discretion or that said Commissioner's action is reviewable. (Cramer & King Co. v. Commissioner of Internal Revenue, 41 F. (2d) 24; Williamsport Wire Rope Company v. United States, 277 U. S. 551; National Bank of Commerce v. United States, 39 F. (2d) 434.)

The order of the Board is reversed with directions to enter one in accordance with the views here expressed.

And on the same day, to-wit: On the tenth day of November, 1933, the following further proceedings were had and entered of record, to-wit:

Friday, November 10, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge; Hon. Evan A. Evans, Circuit Judge; Hon. William M. Sparks, Circuit Judge

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on May 13, 1932, by the United States Board of Tax

Appeals be, and the same is hereby reversed; and that this cause be, and the same is hereby remanded to the said United States Board of Tax Appeals with directions to enter a decision in accordanec with the views expressed in the opinion of this court.

And afterwards, to-wit: On the second day of December, 1933, there was filed in the office of the Clerk of this court an application for stay of mandate, which said application for stay of mandate is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933, OCTOBER SESSION, 1933

4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

APPLICATION FOR STAY OF MANDATE

To the Honorable United States Circuit Court of Appeals for the Seventh Circuit:

Now comes Spring City Foundry Company, the respondent in Cause No. 4912 and the petitioner in Cause No. 4994, and respectfully moves the court to enter an order staying the mandate upon its decision, opinion and order rendered in the above entitled causes on November 10, 1933, because it is the bona fide intention of the Spring City Foundry Company, respondent and petitioner as aforesaid, to make proper and timely application to the Supreme Court of

the United States for a writ of certiorari in said causes, and in support hereof your petitioner attaches hereto the affidavit of Richard H. Tyrrell, one of its counsel herein.

Edgar L. Wood, Richard H. Tyrrell, 213 West Wisconsin Ave., Milwaukee, Wis., Counsel for Spring City Foundry Company, Petitioner.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933, OCTOBER SESSION, 1933

4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

4994

SPRING CITY FOUNDRY COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STATE OF WISCONSIN,
Milwaukee County, ss:

Richard H. Tyrrell, being first duly sworn on oath, deposes and says that he is one of counsel for Spring City Foundry Company, respondent and petitioner respectively in the above entitled causes; that it is the bona fide intention of said Spring City Foundry Company to make proper application to the Supreme Court of the United States within the period of three months from November 10, 1933, for a writ of certiorari in said causes, and that it is affiant's belief that there is merit to the case of said Spring City Foundry Company, and that the decision, opinion and order of this court ought to be reversed as a matter of law by the Supreme Court of the United States. That this affidavit is made in support of the annexed application

of Spring City Foundry Company for an order staying the mandate of this court herein.

Richard H. Tyrrell.

Subscribed and sworn to before me this 1st day of December, 1933. John C. Warner, Notary Public, Milwaukee County, Wisconsin. My commission expires Dec. 23, 1933. (Seal.)

Endorsed: Filed December 2, 1933, Frederick G. Campbell, Clerk.

And on the same day, to-wit: On the second day of December, 1933, the following further proceedings were had and entered of record, to-wit:

Saturday, December 2, 1933.

Court met pursuant to adjournment.

Before Hon. Samuel Alschuler, Circuit Judge

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Now this day comes counsel for petitioner and presents a motion for a stay of the mandate of this court, pending a petition to the Supreme Court of the United States for a writ of certiorari.

On consideration whereof: It is now here ordered that the mandate in this cause be, and the same is hereby stayed until the further order of this court.

It is further ordered that counsel for petitioner proceed with diligence and promptly file the petition for a writ of certiorari in the Supreme Court of the United States and, upon the filing of said petition file in this court proof of the filing of said petition in said court.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages, numbered from 1 to 18, inclusive, contain a true copy of the proceedings had and papers filed (excepting the briefs of counsel, and motions, stipulations and orders relating to the filing of briefs, in the case of Spring City Foundry Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 4994, October Term, 1932, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 5th day of October, A. D. 1933.

Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.
(Seal United States Circuit Court of Appeals, Seventh Circuit.)

[fol. 116] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 5, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, limited to the question whether a debt ascertained to be partially worthless in 1920 was deductible in that year under either Section 234 (a) (4) or Section 234 (a) (5), and to the question whether the debt was returnable as taxable income in that year to the extent that it was then ascertained to be worthless.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.